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Chicago, Illinois 60606

(Address of Principal Executive Offices) (Zip Code)

(877) 235-6925

(Registrant's Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

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

The number of shares of the registrant's common stock outstanding as of October 28, 2016 was 26,524,866.

TABLE OF CONTENTS

	Page
<u>Part I. Financial Information</u>	
Item 1. <u>Financial Statements</u>	1
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	11
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	16
Item 4. <u>Controls and Procedures</u>	17
 <u>Part II. Other Information</u>	
Item 1. <u>Legal Proceedings</u>	18
Item 1A. <u>Risk Factors</u>	18
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	19
Item 6. <u>Exhibits</u>	20
<u>Signatures</u>	21

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## Part I. Financial Information

### Forward-Looking Statements

Statements in this Quarterly Report on Form 10-Q that are not historical facts are “forward-looking statements” and are made pursuant to the safe harbor provisions of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). These forward-looking statements, which may be identified by use of words such as “plan,” “may,” “might,” “believe,” “expect,” “intend,” “could,” “would,” “should,” and other words and terms of similar meaning, in connection with any discussion of our prospects, financial statements, business, financial condition, revenues, results of operations, or liquidity, involve risks and uncertainties that could cause actual results to differ materially from those described in the forward-looking statements. In addition to other factors and matters contained or incorporated in this document, important factors that could cause actual results or events to differ materially from those indicated by such forward-looking statements include, without limitation, those noted under “Risk Factors” included in Part I Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2015, as well as the following:

- Uncertainties associated with the attraction of, and the ability to execute contracts with, new clients, the continuation of existing, and execution of new, engagements with existing clients, the conversion of free pilots to paid subscription contracts, and the timing of related client commitments;
- Reliance on a relatively small number of clients for a significant percentage of our revenue;
- Risks involving the variability and predictability of the number, size, scope, cost, and duration of, and revenue from, client engagements;
- Management of the other risks associated with complex client projects and new service offerings, including execution risk; and
- Management of growth and development of, and introduction of, new service offerings.

We cannot guarantee any future results, levels of activity, performance, or achievements. The statements made in this Quarterly Report on Form 10-Q represent our views as of the date of this report, and it should not be assumed that the statements made in this report remain accurate as of any future date. Moreover, we assume no obligation to update forward-looking statements, except as may be required by law. In light of Regulation FD, it is our policy not to comment on earnings, financial guidance, or operations other than through press releases, publicly announced conference calls, or other means that will constitute public disclosure for purposes of Regulation FD.

## Item 1. Financial Statements

## MATTERSIGHT CORPORATION

## CONSOLIDATED BALANCE SHEETS

(Unaudited and in thousands, except share and per share data)

	September 30,	December 31,
	2016	2015
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 14,652	\$ 15,407
Receivables net of allowances of \$28 and \$24, respectively	5,447	4,863
Prepaid expenses	5,985	4,582
Other current assets	718	235
Total current assets	26,802	25,087
Equipment and leasehold improvements, net of accumulated depreciation and amortization of \$18,263 and \$14,805, respectively	9,743	8,523
Goodwill	972	972
Intangible assets, net of amortization of \$3,699 and \$3,351, respectively	3,262	3,353
Other long-term assets (includes \$4,789 of restricted cash at September 30, 2016)	6,287	2,467
Total assets	\$ 47,066	\$ 40,402
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Short-term debt	\$ 80	\$ —
Accounts payable	1,583	1,223
Accrued compensation and related costs	2,915	2,761
Unearned revenue	2,331	6,378
Capital leases	2,034	1,819
Other current liabilities	4,662	1,796
Total current liabilities	13,605	13,977
Long-term debt	21,339	—
Long-term unearned revenue	857	1,597
Long-term capital leases	1,885	1,614
Other long-term liabilities	5,792	5,689
Total liabilities	43,478	22,877
7% Series B convertible preferred stock, \$0.01 par value; 5,000,000 shares authorized and designated; 1,641,960 and 1,644,768 shares issued and outstanding at September 30, 2016 and December 31, 2015, respectively, with a liquidation preference of \$10,865 and \$10,443, at September 30, 2016 and December 31, 2015, respectively	8,374	8,388

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Stockholders' Equity:

Preferred stock, \$0.01 par value; 35,000,000 shares authorized; none issued	—	—
Common stock, \$0.01 par value; 50,000,000 shares authorized; 27,497,604 and 27,636,853 shares issued at September 30, 2016 and December 31, 2015, respectively; 26,520,854 and 25,849,876 shares outstanding at September 30, 2016 and December 31, 2015, respectively	275	276
Additional paid-in capital	263,906	264,212
Accumulated deficit	(259,944 )	(242,085 )
Treasury stock, at cost, 976,750 and 1,786,977 shares at September 30, 2016 and December 31, 2015, respectively	(4,979 )	(9,239 )
Accumulated other comprehensive loss	(4,044 )	(4,027 )
Total stockholders' (deficit) equity	(4,786 )	9,137
Total liabilities and stockholders' equity	\$ 47,066	\$ 40,402

See accompanying notes to the Unaudited Consolidated Financial Statements.

## MATTERSIGHT CORPORATION

## CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited and in thousands, except per share data)

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
<b>Revenue:</b>				
Subscription revenue	\$ 9,574	\$ 9,313	\$ 27,297	\$ 26,519
Other revenue	838	1,169	2,242	3,021
Total revenue	10,412	10,482	29,539	29,540
<b>Operating expenses:</b>				
Cost of subscription revenue	2,781	1,930	7,840	5,853
Cost of other revenue	662	609	2,044	1,930
Total cost of revenue, exclusive of depreciation and amortization	3,443	2,539	9,884	7,783
Research and development	2,988	3,397	9,588	10,185
Sales and marketing	4,625	3,773	13,452	10,016
General and administrative	2,912	3,108	8,950	8,811
Depreciation and amortization	1,477	1,396	4,295	3,607
Total operating expenses	15,445	14,213	46,169	40,402
Operating loss	(5,033 )	(3,731 )	(16,630 )	(10,862 )
<b>Non-operating income (expense):</b>				
Interest and other borrowing costs	(860 )	(173 )	(1,291 )	(434 )
Change in fair value of warrant liability	58	(22 )	58	3
Other non-operating income	8	2	31	4
Total non-operating income (expense)	(794 )	(193 )	(1,202 )	(427 )
Loss before income taxes	(5,827 )	(3,924 )	(17,832 )	(11,289 )
Income tax provision	(11 )	(15 )	(27 )	(31 )
Net loss	(5,838 )	(3,939 )	(17,859 )	(11,320 )
Dividends related to 7% Series B convertible preferred stock	(147 )	(147 )	(440 )	(441 )
Net loss available to common stock holders	\$ (5,985 )	\$ (4,086 )	\$ (18,299 )	\$ (11,761 )
<b>Per share of common stock:</b>				
Basic net loss available to common stock holders	\$ (0.24 )	\$ (0.17 )	\$ (0.73 )	\$ (0.52 )
Diluted net loss available to common stock holders	\$ (0.24 )	\$ (0.17 )	\$ (0.73 )	\$ (0.52 )
Shares used to calculate basic net loss per share	25,244	24,185	25,156	22,698
Shares used to calculate diluted net loss per share	25,244	24,185	25,156	22,698
Stock-based compensation expense is included in individual line				
items above:				
Total cost of revenue	\$ 112	\$ 63	\$ 298	\$ 187
Research and development	194	294	863	813
Sales and marketing	482	391	1,415	1,112

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General and administrative	463	728	1,718	2,146
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See accompanying notes to the Unaudited Consolidated Financial Statements.



## MATTERSIGHT CORPORATION

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(Unaudited and in thousands)

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Net loss	\$ (5,838)	\$ (3,939 )	\$ (17,859)	\$ (11,320 )
Other comprehensive loss:				
Effect of foreign currency translation	(10 )	(2 )	(17 )	—
Comprehensive net loss	\$ (5,848)	\$ (3,941 )	\$ (17,876)	\$ (11,320 )

See accompanying notes to the Unaudited Consolidated Financial Statements.

## MATTERSIGHT CORPORATION

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited and in thousands)

	For the Nine Months Ended	
	September 30,	September 30,
	2016	2015
Cash Flows from Operating Activities:		
Net loss	\$ (17,859 )	\$ (11,320 )
Adjustments to reconcile net loss to net cash used in operating activities:		
Discount accretion and other debt related costs	173	—
Depreciation and amortization	4,295	3,607
Stock-based compensation	4,294	4,258
Provision for uncollectible accounts	25	—
Change in fair value of warrant liability	(58 )	(3 )
Changes in assets and liabilities:		
Receivables	(609 )	(366 )
Prepaid expenses	(1,448 )	(957 )
Other current assets	(484 )	(240 )
Other long-term assets	(3,820 )	707
Accounts payable	287	75
Accrued compensation and related costs	154	210
Unearned revenue	(4,787 )	(452 )
Other current liabilities	1,375	(2,410 )
Other long-term liabilities	374	4,066
Total adjustments	(229 )	8,495
	(18,088 )	(2,825 )

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Net cash used in operating activities		
Cash Flows from Investing Activities:		
Capital expenditures	(2,364 )	(3,654 )
Investment in intangible assets	(857 )	(660 )
Net cash used in investing activities	(3,221 )	(4,314 )
Cash Flows from Financing Activities:		
Proceeds from line of credit	16,246	15,000
Repayments of line of credit	(16,246 )	(15,000 )
Proceeds from other borrowings	28,880	—
Repayments of other borrowings	(6,030 )	—
Debt issuance costs	(680 )	—
Principal payments on capital lease obligations	(1,727 )	(1,552 )
Proceeds from issuance of common stock, net	—	15,942
7% Series B convertible preferred stock dividend	(3 )	—
Cash paid to satisfy tax withholding upon vesting of employee stock awards	(328 )	(753 )
Proceeds from exercise of stock options	236	220
Proceeds from employee stock purchase plan	223	163
Net cash provided by financing activities	20,571	14,020
Effect of exchange rate changes on cash and cash equivalents	(17 )	1
(Decrease) increase in cash and cash equivalents	(755 )	6,882
Cash and cash equivalents,	15,407	14,238

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beginning of period		
Cash and cash equivalents, end of period	\$ 14,652	\$ 21,120
Non-Cash Investing and Financing Activities:		
Capital lease obligations incurred	\$ 2,213	\$ 2,002
Equipment purchased under capital leases	2,213	2,002
Financing of intellectual property purchase, at fair value	—	2,605
Issuance of warrant, at fair value	924	—
Supplemental Disclosures of Cash Flow Information:		
Interest paid	\$ 758	\$ 155

See accompanying notes to the Unaudited Consolidated Financial Statements.

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note One — Basis of Presentation

The accompanying interim consolidated financial statements include Mattersight Corporation and its subsidiaries (collectively, Mattersight or the company). The accompanying interim consolidated financial statements have been prepared without audit. Certain notes and other information normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted. In the opinion of management, the accompanying consolidated financial statements include all normal recurring adjustments considered necessary to present fairly the financial position of the company at September 30, 2016 and December 31, 2015 and the results of operations and cash flows for the periods indicated. Quarterly results are not necessarily indicative of results for any subsequent period.

A prior year amount has been reclassified from non-operating income (expense) to depreciation and amortization to conform to the current year presentation of the statement of operations. On January 1, 2016, the company adopted Accounting Standards Update (ASU) 2015-03, Interest — Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. ASU 2015-03 simplifies the presentation of debt issuance costs by conforming the presentation of those costs to that of debt discounts and premiums. The standard requires that unamortized debt issuance costs related to a recognized debt liability be presented on the balance sheet as a direct deduction from the carrying amount of the debt liability. Long-term debt is shown net of unamortized debt issuance costs in the company's consolidated balance sheets.

The accompanying unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto in Mattersight's Annual Report on Form 10-K for the year ended December 31, 2015 filed with the Securities and Exchange Commission (SEC) on March 11, 2016.

Note Two — Recent Accounting Pronouncements

In August 2016, the Financial Accounting Standards Board (FASB) issued ASU No 2016-15, "Statement of Cash Flows (Topic 230) Classification of Certain Cash Receipts and Cash Payments", which applies to all entities that are required to present a statement of cash flows under Topic 230. ASU 2016-15 addresses the presentation and classification of cash flows related to (i) debt prepayment or debt extinguishment costs, (ii) settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing, (iii) contingent consideration payments made after a business combination, (iv) proceeds from the settlement of insurance claims, (v) proceeds from the settlement of corporate-owned life insurance policies (including bank-owned life insurance policies), (vi) distributions received from equity method investees, (vii) beneficial interests in securitization transactions, and (viii) separately identifiable cash flows and application of

the predominance principle. The amendments in this update are effective for public business entities for fiscal years beginning after December 15, 2017. The company is currently evaluating the impact of this update on its consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments — Credit Losses: Measurement of Credit Losses on Financial Instruments. This update broadens the information that an entity must consider in developing its expected credit loss estimate for assets measured either collectively or individually. The update is effective for annual periods beginning after December 15, 2019. The company is currently evaluating the impact of this update on its consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting (Topic 718). This update is intended to simplify the accounting for share-based payment transactions, including the income tax impacts, classification of awards as either equity or liabilities, and presentation on the statement of cash flows. The guidance also allows employers to repurchase more of an employee's shares for tax withholding purposes without triggering liability accounting. In addition, the guidance allows for a policy election to account for forfeitures as they occur rather than on an estimated basis. The update is effective for annual periods beginning after December 15, 2016. The company is currently evaluating the impact of this update on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). This update is intended to improve financial reporting of leasing transactions. The ASU will require organizations that lease assets to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. This update is effective for fiscal years beginning after December 15, 2018. The company is currently evaluating the impact of this update on its consolidated financial statements.

In November 2015, the FASB issued ASU No. 2015-17, Income Taxes (Topic 740). This update simplifies the presentation of deferred income taxes and requires that deferred income tax liabilities and assets be classified as noncurrent in a classified statement

of financial position. The update is effective for reporting periods beginning after December 15, 2016 and interim periods within those annual periods. The adoption of ASU 2015-17 is not expected to have a material impact on the company's consolidated financial statements.

In May 2014, FASB issued ASU 2014-09: Revenue from Contracts with Customers (Topic 606). This update sets forth a new five-step revenue recognition model that replaces the prior revenue recognition guidance in its entirety and is intended to eliminate numerous industry-specific pieces of revenue recognition guidance that have historically existed. The underlying principle of the new standard is that an organization will recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects what it expects in exchange for the goods or services. ASU 2014-09 provides alternative methods of initial adoption and is effective for annual periods beginning after December 15, 2017 and interim periods within those annual periods. Early adoption is not permitted prior to December 15, 2016. The company is currently evaluating the impact of this standard on its consolidated financial statements.

#### Note Three — Current Prepaid Expenses

Current prepaid expenses include the current portion of deferred costs and prepaid commissions related to client contracts for the company's predictive behavioral routing, performance management, quality assurance, and predictive analytics applications (collectively, Behavioral Analytics). These costs are recognized over the subscription periods of the respective contracts, generally three to five years after the go-live date. When the company contracts with a client for a short-term pilot, the pilot period generally ranges from three to twelve months after the go-live date.

Current prepaid expenses consisted of the following:

	As of	
	September 30,	December 31,
(In millions)	2016	2015
Deferred costs	\$ 2.0	\$ 1.6
Prepaid commissions	1.8	1.4
Other	2.2	1.6
Total	\$ 6.0	\$ 4.6

#### Note Four — Other Long-Term Assets

Other long-term assets includes the long-term portion of deferred costs, prepaid commissions related to Behavioral Analytics, and restricted cash. Restricted cash represents cash used to collateralize certain letters of credit issued to support the company's equipment leasing activities. Other long-term assets consisted of the following:

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As of  
September  
30, December 31,

(In millions)	2016	2015
Restricted cash	\$4.8	\$ —
Deferred costs	0.7	0.9
Prepaid commissions	0.1	1.2
Deferred tax asset	0.1	0.1
Other prepaid expenses	0.6	0.3
Total	\$6.3	\$ 2.5



## Note Five — Other Current Liabilities

Other current liabilities consisted of the following:

(In millions)	As of	
	September 30, 2016	December 31, 2015
Accrued vendor payable	\$ 1.6	\$ 0.7
Warrant liability	0.9	—
Deferred rent liability	0.4	0.3
Other	1.8	0.8
<b>Total</b>	<b>\$ 4.7</b>	<b>\$ 1.8</b>

On August 1, 2016, the company entered into a secured loan agreement with Hercules Capital, Inc., as agent and lender (Hercules). See Note Seven – Debt. Concurrent with the loan agreement, the company issued a warrant to Hercules that gives Hercules the right to purchase shares of the company’s common stock at \$3.50 per share. Initially, the warrant is exercisable for 357,142 shares of common stock. If the company borrows the entire third tranche of \$5.0 million available under the loan agreement, the warrant will be exercisable for 428,570 shares of common stock. The warrant expires on August 1, 2023. The warrant is accounted for as a liability and carried at fair market value using the Black-Scholes model. Upon issuance, the Black-Scholes fair value was determined using a risk-free rate of 1.33%, expected volatility of 53% and an expected term of 7 years. The warrant liability is revalued on a quarterly basis. Changes in the warrant’s fair market value are recognized in non-operating income (expense) in the consolidated statements of operations.

## Note Six — Leases

## Capital Leases

Assets under capital leases consist primarily of computer hardware and related equipment. The gross amount of assets recorded under capital leases was \$7.2 million and \$5.4 million at September 30, 2016 and December 31, 2015, respectively. Depreciation expense related to assets under capital leases is included in depreciation and amortization expense on the consolidated statements of operations.

As of September 30, 2016, the future minimum lease payments due under capital leases are expected to be as follows:

(In millions)	Amount
Year	
Remainder of 2016	\$ 0.6
2017	2.1

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2018	1.3
2019	0.2
Total minimum lease payments	\$ 4.2
Less: estimated executory costs	—
Net minimum lease payments	\$ 4.2
Other Less: amount representing interest	(0.3 )
Present value of minimum lease payments	\$ 3.9

Note Seven — Debt

On August 1, 2016, the company entered into a secured loan agreement with Hercules. The agreement, which matures on February 1, 2020, allows the company to borrow up to \$30.0 million in three tranches. On August 1, 2016, the company borrowed \$22.5 million. The second tranche of up to \$2.5 million will become available starting July 1, 2017 and continuing until September 15, 2017, contingent on the company meeting certain financial milestones. The third tranche of up to \$5.0 million will become available starting September 15, 2017 and continuing until September 15, 2018, contingent on meeting certain financial milestones, a portion of which will be mutually determined by the company and Hercules and will be subject to approval by Hercules.

The annual interest rate is equal to the greater of (i) 9.75% plus the prime rate minus 3.50% or (ii) 9.75%. Additionally, the principal balance will bear compounding payment-in-kind interest at an annual rate of 2.15%. Monthly payments are interest only until December 1, 2017, subject to extension until March 1, 2018 or June 1, 2018 depending on whether certain financial milestones

are met. After the interest-only period, principal and interest will be due in equal monthly payments. The company may prepay all, but not a portion, of the loan. A prepayment charge of 3.0%, 2.0% or 1.0% of the outstanding balance would be due in year one, in year two, or after year two, respectively.

Initially, the agreement's covenants require the company (i) to achieve at least 80% of its trailing 6 month projected subscription revenues and (ii) to maintain at least \$7.5 million in unrestricted cash. After the company achieves two consecutive quarters of earnings before interest, taxes, and depreciation and amortization of at least \$1.0 million, the minimum requirement for unrestricted cash will decrease to \$6.0 million. The agreement is secured by substantially all of the company's assets, including its intellectual property.

Prior to entering into the secured loan agreement with Hercules, the company was party to a credit facility and term loan with Silicon Valley Bank. The credit facility and term loan were terminated on August 1, 2016. The company used a portion of the proceeds from the Hercules secured loan agreement to repay its \$6.0 million term loan with Silicon Valley Bank and to pay borrowing-related fees and expenses. The company expects to use the remaining proceeds and any future borrowings under the Hercules secured loan agreement for general corporate purposes.

In the third quarter of 2016, the company also entered into financing agreements to furnish its new facility in Austin, Texas.

Debt consisted of the following at September 30, 2016:

(In millions)	Amount
Hercules loan due February 1, 2020, effective rate of 14.50%	\$ 22.5
Furniture loan due May 2021, effective rate of 9.10%	0.1
Furniture loan due May 2021, effective rate of 9.55%	0.1
Furniture loan due July 2019, effective rate of 13.98%	0.2
Total debt <sup>(1)</sup>	\$ 22.9

(1)The current portion of the principal due was \$0.1 million at September 30, 2016.

The balance of long-term debt in the consolidated balance sheet includes \$0.6 million of unamortized debt costs and \$0.9 million of unaccreted debt discount.

Debt maturities were as follows as of September 30, 2016:

(In millions)	Amount
Year	
Remainder of 2016*	\$ —
2017	0.7

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2018	8.4
2019	9.2
2020	4.5
Thereafter	0.1

\*Less than \$0.1 million.

Note Eight — Other Long-Term Liabilities

Other long-term liabilities consisted of the following:

(In millions)	As of	
	September 30, 2016	December 31, 2015
7% Series B convertible preferred stock dividend payable	\$ 2.5	\$ 2.1
Deferred rent liability	1.9	1.7
Intellectual property purchase liability	1.1	1.6
Deferred tax liability	0.3	0.3
Total	\$ 5.8	\$ 5.7

8

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## Note Nine — Loss Per Share

The following table presents the loss per share calculation for the periods presented:

	For the Quarter Ended		For the Nine Months	
	September 30,	September 30,	September 30,	September 30,
(In millions)	2016	2015	2016	2015
Net loss	\$(5.8 )	\$( 3.9 )	\$(17.9 )	\$( 11.3 )
Dividends related to 7% Series B convertible preferred stock <sup>(1)</sup>	(0.2 )	(0.2 )	(0.4 )	(0.5 )
Net loss available to common stock holders	\$(6.0 )	\$( 4.1 )	\$(18.3 )	\$( 11.8 )
Per share of common stock:				
Basic/diluted net loss available to common stock holders	\$(0.24 )	\$( 0.17 )	\$(0.73 )	\$( 0.52 )
(In thousands)				
Weighted average shares outstanding (basic and diluted)	25,244	24,185	25,156	22,698
Anti-dilutive common stock equivalents <sup>(2)</sup>	1,772	2,193	1,691	2,133

(1) Dividends on 7% Series B convertible preferred stock (Series B stock) are cumulative and have been accrued from July 1, 2012 to September 30, 2016. The total accrued dividends are \$2.5 million as of September 30, 2016, which will continue to be accrued until they are declared by the board of directors.

(2) The effect of common stock equivalents, which is primarily related to the Series B stock, was not included in the diluted loss per share calculation as it was anti-dilutive.

## Note Ten — Fair Value of Financial Instruments

The company uses a three-level classification hierarchy of fair value measurements to report certain assets and liabilities at fair value. The first tier, Level 1, uses quoted market prices in active markets for identical assets or liabilities. Level 2 uses observable market data, such as quoted market prices for similar assets and liabilities in active markets, or inputs other than quoted prices that are directly observable. Level 3 uses entity-specific inputs or unobservable inputs that are derived and cannot be corroborated by market data. A financial asset or liability's classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

The following table presents financial instruments measured at fair value measured on a recurring basis at September 30, 2016:

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(In millions)	Carrying value	Level 1	Level 2	Level 3
Cash and cash equivalents - money market fund	\$ 14.3	\$ 14.3	\$ —	\$ —
Warrant liability	0.9	\$—	\$ —	0.9

The carrying values of other cash and cash equivalents, accounts receivable, accounts payable, and short-term debt approximated their fair values as of September 30, 2016 due to the short-term nature of these instruments.

The company determined the fair value of the warrant liability, considered a Level 3 liability, using the Black-Scholes model. At September 30, 2016, management used a risk free rate of 1.40%, expected volatility of 53%, and an expected term of 6.84 years. Initially, the warrant is exercisable for 357,142 shares of common stock. If the company borrows the entire third tranche of \$5.0 million available under the Hercules secured loan agreement, the warrant will be exercisable for 428,570 shares of common stock. (See Note 5 – Other Current Liabilities) As of September 30, 2016, a probability of 0% was assigned to a draw of the third tranche. Significant increases or decreases in any of these inputs in isolation would result in a significantly different fair value.

Fair values for assets and liabilities that are only disclosed and not recorded consist of long-term debt. The fair value of long-term debt was estimated to be \$22.9 million at September 30, 2016.

There were no transfers of assets or liabilities between Level 1, Level 2, and Level 3 during the first nine months of 2016. There were no assets or liabilities valued at fair value on a nonrecurring basis during the first nine months of 2016.

Note Eleven — Litigation and Other Contingencies

The company is a party to various agreements, including all client contracts, under which it may be obligated to indemnify the other party with respect to certain matters, including, but not limited to, indemnification against third-party claims of infringement of intellectual property rights with respect to services, software, and other deliverables provided by the company. These obligations may be subject to various limitations on the remedies available to the other party, including, without limitation, limits on the amounts recoverable and the time during which claims may be made, and may be supported by indemnities given to the company by applicable third parties. Payment by the company under these indemnification clauses is generally subject to the other party making a claim that is subject to challenge by the company. Historically, the company has not been obligated to pay any claim for indemnification under its agreements, and management is not aware of future indemnification payments that it would be obligated to make.

Under its by-laws, subject to certain exceptions, the company has agreed to indemnify its corporate officers and directors for certain events or occurrences while the officer or director is, or was, serving at its request in such capacity or in certain related capacities. The company has separate indemnification agreements with each of its corporate officers and directors that requires it, subject to certain exceptions, to indemnify them to the fullest extent authorized or permitted by its by-laws and the Delaware General Corporation Law. The maximum potential amount of future payments the company could be required to make under these indemnification agreements is unlimited; however, the company has a director and officer liability insurance policy that limits its exposure and enables it to recover a portion of any amounts paid under these indemnification agreements. As a result of its insurance policy coverage, the company believes the estimated fair value of these indemnification agreements is minimal. The company had no liabilities recorded for these agreements as of September 30, 2016.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion is provided as a supplement to, and should be read in conjunction with, the accompanying unaudited consolidated financial statements and notes in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the year ended December 31, 2015.

### Background

Mattersight Corporation and its subsidiaries (collectively, we, us, or ours) is a leader in behavioral analytics and a pioneer in personality-based software products. Using a stack of innovative, patented applications, including predictive behavioral routing, performance management, quality assurance, and predictive analytics (collectively, Behavioral Analytics), we analyze and predict customer behavior based on the language exchanged between agents and customers during brand interactions. These insights are then used to facilitate more effective and effortless customer conversations, which, in turn, drive increased customer satisfaction and retention, employee engagement, and operating efficiency. Our analytics are based on millions of proprietary algorithms and the application of unique behavioral models. Our solutions have influenced hundreds of millions of shorter, more satisfying customer interactions for leading companies in the healthcare, insurance, financial services, technology, telecommunications, cable, utilities, education, hospitality, and government industries.

Our multi-channel technology captures the unstructured data of voice interactions (conversations), related customer and employee data, and employee desktop activity, and applies millions of proprietary algorithms against those interactions. Each interaction contains hundreds of attributes that get scored and ultimately detect patterns of behavior or business process that provide the transparency and predictability necessary to enhance revenue, improve the customer experience, improve efficiency, and predict and navigate outcomes. Adaptive across industries, programs, and industry-specific processes, our Behavioral Analytics offerings enable our clients to drive measurable economic benefit through the improvement of contact center performance, customer satisfaction and retention, fraud reduction, and streamlined back office operations. Specifically, through our Behavioral Analytics offerings, we help clients:

- Identify optimal customer/employee behavioral pairing for call routing;
- Identify and understand customer personality;
- Automatically measure customer satisfaction and agent performance on every analyzed call;
- Improve rapport between agent and customer;
- Reduce call handle times while improving customer satisfaction;
- Identify opportunities to improve self-service applications;
- Improve cross-sell and up-sell success rates;
- Improve the efficiency and effectiveness of collection efforts;
- Measure and improve supervisor effectiveness and coaching;
- Improve agent effectiveness by analyzing key attributes of desktop usage;
- Predict likelihood of customer attrition;
- Predict customer satisfaction and Net Promoter Scores® without customer surveys;
- Predict likelihood of debt repayment;
- Predict likelihood of a sale or cross-sell; and
- Identify fraudulent callers and improve authentication processes.

Our mission is to help brands have more effective and effortless conversations with their customers. Using a suite of innovative personality-based software applications, we can analyze and predict customer behavior based on the language exchanged during service and sales interactions. We operate a highly scalable, flexible, and adaptive application platform to enable clients to implement and operate these applications.





## Business Metrics

We regularly review the following business metrics to evaluate our business, measure our performance, identify trends in our business, prepare financial projections, and make strategic decisions.

**ACV Bookings.** We estimate the annual contract value (ACV) of bookings as equal to the projected subscription and other billings for new customer contracts executed in the quarter, realized growth on existing customer accounts beyond the original booking, and committed future growth. We regularly review ACV bookings on a rolling four quarter basis and also review the percentage of ACV bookings generated by new customers. We use this to measure the effectiveness of our sales and marketing investments and as an indicator of potential future billings.

**Backlog.** We calculate the backlog as the ACV of bookings for which we have not yet deployed our services to the customer. We use this to measure the average time to deploy our bookings and as an indicator of potential future billings.

**Gross Margin.** We calculate gross margin as the difference between our total revenue and the total cost of revenue, divided by total revenue, expressed as a percentage. We use this to measure the efficiency of our service delivery organization.

## Performance Highlights

The following table presents our key metrics for the periods presented:

	For the Quarters Ended		
	March 31	June 30,	September 30,
(Dollars in millions)	2016	2016	2016
ACV bookings	\$5.4	\$ 4.4	\$ 4.7
Rolling four quarters ACV bookings	\$25.1	\$ 23.7	\$ 21.5
Backlog	\$17.9	\$ 23.1	\$ 19.2
Gross margin	68 %	65 %	67 %

	For the Quarters Ended		
	March 31	June 30,	September 30,
(Dollars in millions)	2015	2015	2015
ACV bookings	\$3.1	\$ 5.8	\$ 6.9
Rolling four quarters ACV bookings	\$17.1	\$ 19.0	\$ 22.6
Backlog	\$8.1	\$ 10.0	\$ 11.7
Gross margin	72 %	73 %	76 %

## Business Outlook

Based on research from third-party analysts, we believe the call center industry is ripe for disruption and innovation. We believe what the call center was designed to accomplish and how it was measured are parts of an outdated mode

of business that is disconnected from the needs of today's consumer. In fact, research from the CEB suggests that any call center interaction is four times more likely to drive customer disloyalty. Given a rise in self-service, these interactions are only becoming more complex and fraught with greater risk.

Through Behavioral Analytics, we seek to provide our clients with personality-based software applications that mitigate the complexity and reduce the risk of these call center interactions. According to Gartner, Inc., there were six million call center seats in North America in 2015, and less than 1% of this market is penetrated by personality-based software applications. We believe that we are uniquely positioned to capitalize on this opportunity. Our strategy to increase revenue and capture market share includes the following elements:

- Drive new bookings growth and increase operating leverage;
- Leverage a “land & expand” model, focused on personality-based routing as the catalyst for new client acquisition;
- Cross-sell coaching, quality assurance, and analytic products after delivering a routing solution;
- Continue to invest in innovative linguistic models and behavioral science;
- Expand our sales and marketing capacity; and
- Test the applicability of our proprietary personality-based software applications with clients outside of the call center industry.

12

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Our personality-based software applications, which have been developed through substantial investment over the past decade, are deeply embedded into our clients' infrastructure and workflows. Our long-term client relationships are made up largely of multi-year contracts with high contract renewal rates. Our aspiration is that our "land & expand" model, focused on our routing product, will continue to accelerate the acquisition of new clients.

Results of Operations (Dollars in millions)	Quarter ended September 30,			Nine months ended September 30,		
	2016	2015	Change	2016	2015	Change
Total revenue	\$10.4	\$10.5	(1 )%	\$29.5	\$29.5	—
Total cost of revenue, exclusive of depreciation and amortization	3.4	2.5	36 %	9.9	7.8	27 %
Gross margin	7.0	8.0	(12 )%	19.6	21.7	(10 )%
Other operating expenses	12.0	11.7	3 %	36.3	32.6	11 %
Operating loss	5.0	3.7	35 %	16.6	10.9	53 %
Non-operating expenses	0.8	0.2	311 %	1.2	0.4	181 %
Net loss	5.8	3.9	48 %	17.9	11.3	58 %

### Third Quarter of 2016 Compared with Third Quarter of 2015

#### Revenue

Our total revenue decreased by \$0.1 million, or 1%, in the third quarter of 2016, when compared with the third quarter of 2015. The decrease consisted of a \$0.4 million decrease in other revenue offset by a \$0.3 million increase in subscription revenue. Other revenue decreased primarily due to reduced recognition of deployment fees. Deployment fees are deferred and recognized over the contract's subscription period beginning on the go-live date. If a contract terminates early, remaining deferred deployment revenue is recognized upon termination. Subscription revenue increased primarily due to \$2.2 million from new client contracts, partially offset by a decrease of \$1.9 million from terminating client contracts.

Our top five clients accounted for 76% of total revenue in the third quarter of 2016 and 74% of total revenue in the third quarter of 2015. Our top ten clients accounted for 90% of total revenue in the third quarter of 2016 and 93% of total revenue in the third quarter of 2015. In both the third quarter of 2016 and 2015, three clients each accounted for 10% or more of total revenue. In the third quarter of 2016, United HealthCare Services, Inc., CVS Caremark Corporation, and Progressive Casualty Insurance Company accounted for 35%, 15%, and 13% of total revenue, respectively. In the third quarter of 2015, United HealthCare Services, Inc., Progressive Casualty Insurance Company, and CVS Caremark Corporation accounted for 30%, 15%, and 11% of total revenue, respectively. Higher concentration of revenue with a single client or a limited group of clients creates increased revenue risk if one of these clients significantly reduces its demand for our services.

#### Total Cost of Revenue, Exclusive of Depreciation and Amortization

Cost of subscription revenue was \$2.8 million, or 29% of subscription revenue, in the third quarter of 2016, compared with \$1.9 million, or 21% of subscription revenue, in the third quarter of 2015. The cost of subscription revenue increased by \$0.9 million or 44%, primarily due to increased personnel costs.

## Other Operating Expenses

Other operating expenses include research and development, sales and marketing, general and administrative, and depreciation and amortization. Other operating expenses increased in the third quarter of 2016 when compared to the third quarter of 2015 primarily as a result of \$0.9 million increased sales and marketing expenses, partially offset by a \$0.4 million decrease in research and development expenses.

Sales and marketing expenses consist primarily of salaries, incentive compensation, commissions, and employee benefits for business development, account management, and marketing. Sales and marketing expenses increased \$0.9 million, or 23%, in the third quarter of 2016 when compared with the third quarter of 2015. The increase was primarily due to one-time severance benefits, as well as increased compensation costs related to the expansion of our sales and marketing teams.

Research and development expenses decreased in the third quarter of 2016 primarily due to decreased compensation costs.

## Non-Operating Expenses

Non-operating expenses consist primarily of interest and other borrowing costs, changes in the fair value of the warrant liability and other non-operating income.

Interest and other borrowing costs increased \$0.7 million in the third quarter of 2016 when compared with the third quarter of 2015, primarily as a result of our secured loan agreement with Hercules, which originated on August 1, 2016.

## Income Tax Provision

The income tax provision was less than \$0.1 million in the third quarter of both 2016 and 2015. As of September 30, 2016 and 2015, total net deferred tax assets of approximately \$82.0 million and \$73.7 million, respectively, were fully offset by a valuation allowance. Net deferred tax assets consist primarily of U.S. and non-U.S. net operating losses. Due to uncertainty in predicting when we will achieve the profitability required to utilize our operating losses we have recognized a valuation allowance for the full amount of our net deferred tax assets.

## First Nine Months of 2016 Compared with First Nine Months of 2015

### Revenue

Our total revenue remained flat at \$29.5 million in the first nine months of 2016 when compared with the first nine months of 2015, as a result of a \$0.8 million increase in subscription revenue offset by a \$0.8 million decrease in other revenue. Subscription revenue increased primarily due to \$3.6 million from new client contracts, partially offset by a decrease of \$2.7 million from terminating contracts. Other revenue decreased primarily due to recognition of less deferred deployment fees. Deployment fees are deferred and recognized over the contract's subscription period beginning on the go-live date. If a contract terminates early, remaining deferred deployment revenue is recognized upon termination.

Our top five clients accounted for 73% of total revenue in the first nine months of 2016 and 74% of total revenue in the first nine months of 2015. Our top ten clients accounted for 89% of total revenue in the first nine months of 2016 and 91% of total revenue in the first nine months of 2015. In both the first nine months of 2016 and 2015, three clients each accounted for 10% or more of total revenue. In the first nine months of 2016, United HealthCare Services, Inc., CVS Caremark Corporation, and Progressive Casualty Insurance Company accounted for 33%, 15%, and 13% of total revenue, respectively. In the first nine months of 2015, United HealthCare Services, Inc., Progressive Casualty Insurance Company, and CVS Caremark Corporation accounted for 30%, 16%, and 12% of total revenue, respectively. Higher concentration of revenue with a single client or a limited group of clients creates increased revenue risk if one of these clients significantly reduces its demand for our services.

### Total Cost of Revenue, Exclusive of Depreciation and Amortization

Cost of subscription revenue was \$7.8 million, or 29% of subscription revenue, in the first nine months of 2016, compared with \$5.9 million, or 22% of subscription revenue, in the first nine months of 2015. Cost of subscription revenue increased by \$1.9 million, or 34%, primarily due to increased personnel costs.

### Other Operating Expenses

Other operating expenses include research and development, sales and marketing, general and administrative, and depreciation and amortization. Other operating expenses increased in the first nine months of 2016 when compared to

the first nine months of 2015 primarily as a result of a \$3.4 million increase in sales and marketing expenses and a \$0.7 million increase in depreciation and amortization, partially offset by a \$0.6 million decrease in research and development expenses.

Sales and marketing expenses increased \$3.4 million, or 34%, in the first nine months of 2016 when compared with the first nine months of 2015. The increase was primarily due to an expansion of our sales and marketing teams, one-time severance benefit costs, and increased travel costs.

Depreciation and amortization increased \$0.7 million, or 19%, in the first nine months of 2016 when compared with the first nine months of 2015. The rise in expense resulted primarily from increased investments in technology, as well as the build out of our new Chicago office in late 2015.

Research and development expenses decreased in the first nine months of 2016 primarily due to decreased compensation costs.

## Non-Operating Expenses

Interest and other borrowing costs increased \$0.9 million in the first nine months of 2016 when compared with the first nine months of 2015, primarily as a result of our term loan with Hercules, which originated on August 1, 2016, and increased capital lease obligations.

## Income Tax Provision

The income tax provision was less than \$0.1 million in the first nine months of both 2016 and 2015. As of September 30, 2016 and 2015, total net deferred tax assets of approximately \$82.0 million and \$73.7 million, respectively, were fully offset by a valuation allowance. Net deferred tax assets consist primarily of U.S. and non-U.S. net operating losses. Due to uncertainty in predicting when we will achieve the profitability required to utilize our operating losses, we have recognized a valuation allowance for the full amount of our net deferred tax assets.

## Liquidity and Capital Resources

### Sources and Uses of Cash

Our principal capital requirements are to fund working capital needs, capital expenditures for Behavioral Analytics and infrastructure requirements, and other revenue generation and growth investments. Our principal capital resources consisted of cash and cash equivalents of \$14.7 million and \$15.4 million at September 30, 2016 and December 31, 2015, respectively.

Net cash used in operating activities increased by \$15.3 million in the first nine months of 2016 when compared with the same period in 2015. The increase in net cash used in operating activities was largely attributable to increases in cost of revenue, and sales and marketing expenses, as well as a \$4.8 million increase in restricted cash used to collateralize letters of credit for equipment leasing. Cash used in investing activities decreased by \$1.1 million in the first nine months of 2016 when compared with the same period in 2015 primarily due to a decrease in capital expenditures. Net cash provided by financing activities increased by \$6.6 million primarily as a result of \$22.5 million in debt proceeds from Hercules (see Credit Facility below). Additionally, we received \$15.9 million in proceeds from common stock in 2015.

Historically, we have not paid cash dividends on our common stock, and we do not expect to do so in the future. Our Series B stock accrues dividends at a rate of 7% per year, payable semi-annually in January and July if declared by our board of directors. If not declared, unpaid dividends are cumulative and accrue at the rate of 7% per year. The board of directors has not declared a dividend payment on the Series B stock, which has been accrued, from July 1, 2012 through September 30, 2016 (the aggregate amount of these dividends was approximately \$2.5 million). Payment of future dividends on the Series B stock will be determined by the board of directors based on our business outlook and macroeconomic conditions and is subject to approval by Hercules under the terms of our new secured loan agreement. The amount of each dividend accrual will be decreased by any conversions of the Series B stock into common stock, as such conversions require us to pay accrued but unpaid dividends at the time of conversion. Conversions of Series B stock are at the option of the holder.

### Liquidity

As of September 30, 2016, our near-term capital resources consisted of our current cash balance, together with anticipated future cash flows, financing from capital leases, and borrowing capacity (see Credit Facility below). Our balance of cash and cash equivalents was \$14.7 million as of September 30, 2016.



We anticipate that our current unrestricted cash resources, together with operating revenue, capital lease financing, and borrowing capacity, should be sufficient to satisfy our short-term working capital and capital expenditure needs for the next twelve months. Management will continue to assess opportunities to maximize cash resources by actively managing our cost structure and closely monitoring the collection of our accounts receivable. If, however, our operating activities, capital expenditure requirements, or net cash needs differ materially from current expectations due to uncertainties surrounding the current capital market, credit and general economic conditions, competition, or the termination of a large client contract, then there is no assurance that we would have access to additional external capital resources on acceptable terms.

## Credit Facility

On August 1, 2016, we entered into a secured loan agreement with Hercules under which we may borrow up to \$30.0 million in three tranches. On August 1, 2016, we borrowed the first tranche of \$22.5 million and paid a facility charge of \$250,000. The second tranche of up to \$2.5 million is available beginning July 1, 2017 and continuing until September 15, 2017, provided that specified conditions are satisfied, including that we have achieved at least 85% of projected bookings and revenues for the six month period ending June 30, 2017. The third tranche of up to \$5.0 million is available beginning on September 15, 2017 and continuing until September 15, 2018, provided that specified conditions are satisfied, including that we have achieved (i) at least 85% of projected bookings and revenues for the six month period ending June 30, 2017 and (ii) additional performance milestones that Hercules and we mutually agree upon. There is \$50,000 facility charge we must pay if we borrow the third tranche. Our obligations under the secured loan agreement are secured by a security interest in substantially all of our assets, including our intellectual property.

The per annum interest rate for any outstanding loans under the Hercules secured loan agreement is the greater of (i) 9.75% plus the prime rate as reported in The Wall Street Journal minus 3.50%, and (ii) 9.75%, computed on a daily basis. In addition to the interest accrued pursuant to the foregoing interest rate, the principal balance of any outstanding loans under the secured loan agreement will bear payment-in-kind interest at a rate of 2.15% per annum, computed on a daily basis, and such amount will be added to the outstanding principal balance outstanding on the loans. Monthly payments under the secured loan agreement are interest only until December 1, 2017 (which may be extended to March 1, 2018 if specified conditions are met, including that we have achieved at least 80% of projected revenue for the quarter ending September 30, 2017, and to June 1, 2018 if specified conditions are met, including that we have achieved at least 80% of projected revenue for the quarter ending December 31, 2017) followed by 30 equal monthly payments of principal and interest; provided that any outstanding principal and all accrued but unpaid interest will be due and payable on February 1, 2020. We may elect to prepay prior to maturity all, but not less than all, of the outstanding amounts under the secured loan agreement, including interest. If we elect to prepay the outstanding amounts under the secured loan agreement prior to maturity, a prepayment charge of 3.0%, 2.0%, or 1.0% of the then outstanding principal balance (including any accrued payment-in-kind interest added as principal) also will be due, depending upon whether we prepay in year one, in year two, or after year two of the closing date, respectively. In addition, we will be required to prepay all such outstanding amounts and such prepayment charge upon the occurrence of a change in control.

Prior to entering into the secured loan agreement with Hercules, the company was party to a credit facility and term loan with Silicon Valley Bank. The credit facility and term loan were terminated on August 1, 2016. We used a portion of the proceeds from the initial borrowings under the Hercules secured loan agreement to repay our term loan with Silicon Valley Bank and to pay borrowing-related fees and expenses. We expect to use the remaining proceeds and any future borrowings under the Hercules secured loan agreement with Hercules for general corporate purposes.

## Capital Lease Obligations

We are a party to capital lease agreements with leasing companies to fund our on-going equipment requirements. Capital lease obligations were \$3.9 million as of September 30, 2016 and \$3.4 million as of December 31, 2015. We expect to incur new lease obligations of between \$2.7 million to \$3.2 million for fiscal year 2016, as we continue to expand our investment in our technology infrastructure. As of September 30, 2016, we had standby letters of credit totaling \$4.8 million issued as collateral for capital leases.

## Accounts Receivable Customer Concentration

Days Sales Outstanding (DSO) was 48 days at September 30, 2016, compared with 41 days at December 31, 2015, an increase of 7 days. Because a high percentage of our revenue is dependent on a relatively small number of clients, delayed payments by a few of our larger clients could result in a reduction of our available cash, which in turn may cause fluctuation in our DSO. At this time, we do not anticipate significant collection issues with our clients.

As of September 30, 2016, two clients, United HealthCare Services, Inc., and CVS Caremark Corporation accounted for 40%, and 28% of total gross accounts receivable, respectively. As of November 7, 2016, we had collected 30% of United HealthCare Services, Inc.'s outstanding accounts receivable and 65% of CVS Caremark Corporation's outstanding accounts receivable. Of the total September 30, 2016 gross accounts receivable, we have collected 47% as of November 7, 2016. Because a high percentage of our revenue is dependent on a relatively small number of clients, delayed payments by a few of our larger clients could result in a reduction of our available cash.

### Item 3. Quantitative and Qualitative Disclosures about Market Risk

There have been no material changes in our exposure to market risk since December 31, 2016. Refer to Item 7A in our Annual Report on Form 10-K for the year ended December 31, 2015.

#### Item 4. Controls and Procedures

##### Evaluation of Disclosure Controls and Procedures

Management, with the participation of the Chief Executive Officer and Chief Financial Officer, has performed an evaluation of our disclosure controls and procedures that are defined in Rule 13a-15 of the Exchange Act as of the end of the period covered by this report. This evaluation included consideration of the controls, processes, and procedures that are designed to ensure that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the SEC and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Based on this evaluation, our management, including our Chief Executive Officer and Interim Chief Financial Officer, concluded that, as of September 30, 2016, our disclosure controls and procedures were effective.

Our management, including our Chief Executive Officer and Interim Chief Financial Officer, has concluded that the financial statements included in this Quarterly Report on Form 10-Q present fairly, in all material respects, our financial position, results of operations, and cash flows for the periods presented in conformity with accounting principles generally accepted in the United States.

##### Changes in Internal Control over Financial Reporting

There has been no change in our internal control over financial reporting that occurred during the third quarter of 2016 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## Part II. Other Information

### Item 1. Legal Proceedings

None.

### Item 1A. Risk Factors

There are a number of risks and uncertainties that could adversely affect our business and our overall financial performance. In addition to the matters discussed elsewhere in this Quarterly Report on Form 10-Q, we believe the more significant of such risks and uncertainties include the following (for a description of the risk factors, see Item 1A. Risk Factors included in our Annual Report on Form 10-K for the year ended December 31, 2015):

- We have not realized an operating profit in sixteen years and there is no guarantee that we will realize an operating profit in the foreseeable future.
- Our financial results are subject to significant fluctuations because of many factors, any of which could adversely affect our stock price.
- We depend on a limited number of clients for a significant portion of our revenue, and the loss of a significant client or a substantial decline in the size or scope of deployments for a significant client, could have a material adverse effect on our business.
- We depend on good relations with our clients, and any harm to these good relations may materially and adversely affect our business and our ability to compete effectively.
- We must maintain our reputation and expand our name recognition to remain competitive.
- Our industry is very competitive and, if we fail to compete successfully, our market share and business will be adversely affected.
- We must keep pace with the rapid rate of innovation in our industry in order to build our business.
- Because our services and solutions are sophisticated, we must devote significant time and effort to our sales and installation processes, with significant risk of loss if we are not successful.
- The unauthorized disclosure of the confidential customer data that we maintain could result in a significant loss of business and subject us to substantial liability.
- Our financial results could be adversely affected by economic and political conditions and the effects of these conditions on our clients' businesses and levels of business activity.
- We rely heavily on our senior management team for the success of our business.
- Our ability to recruit talented professionals and retain our existing professionals is critical to the success of our business.
- We have a limited ability to protect our intellectual property rights, which are important to our success and competitive position.
- Others could claim that our services, products, or solutions infringe upon their intellectual property rights or violate contractual protections.
- Increasing government regulation could cause us to lose clients or impair our business.
- It may be difficult for us to access debt or equity markets to meet our financial needs.
- The market price of our common stock is likely to be volatile and could subject us to litigation.
- Because we do not anticipate paying any cash dividends on our common stock in the foreseeable future, capital appreciation, if any, will be your sole source of gains and you may never receive a return on your investment.
- We identified a material weakness in our internal control over financial reporting, and our business and stock price may be adversely affected if we do not adequately address this weakness or if we have other material weaknesses or significant deficiencies in our internal control over financial reporting in the future.
  - Our operating results may be negatively affected if we are required to collect sales tax or other transaction taxes on all or a portion of sales in jurisdictions where we are currently not collecting and reporting tax.



There have been no material changes in these risk factors from those described in our Annual Report on Form 10-K for the year ended December 31, 2015.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Repurchase of Equity Securities

The following table provides information relating to our purchase of shares of common stock in the third quarter of 2016. All of these purchases reflect shares withheld to satisfy tax withholding obligations related to vesting of restricted stock. We have not adopted a common stock repurchase plan or program.

Period	Total Number of Shares Purchased (1)	Average Price Paid Per Share
July 1, 2016 – July 31, 2016	49	\$ 3.84
August 1, 2016 – August 31, 2016	23,231	\$ 3.88
September 1, 2016 – September 30, 2016	6,493	\$ 4.09
Total	29,773	\$ 3.92

(1)The shares reflected in this column were purchased in order to satisfy tax withholding obligations related to the vesting of restricted stock awards issued pursuant to our 1999 Stock Incentive Plan.

Item 6. Exhibits

- 3.1.1 Certificate of Incorporation of Mattersight Corporation, as amended (incorporated by reference to Exhibit 3.1 to Amendment No. 1 to Mattersight Corporation's Registration Statement on Form S-1 (File No. 333-94293) as filed with the Securities and Exchange Commission on February 1, 2000).
- 3.1.2 Certificate of Amendment to Mattersight Corporation's Certificate of Incorporation effective December 19, 2001 (incorporated by reference to Exhibit 3.3 to Mattersight Corporation's Annual Report on Form 10-K (File No. 000-27975) as filed with the Securities and Exchange Commission on March 28, 2002).
- 3.1.3 Certificate of Amendment to Mattersight Corporation's Certificate of Incorporation effective December 19, 2001 (incorporated by reference to Exhibit 3.4 to Mattersight Corporation's Annual Report on Form 10-K (File No. 000-27975) as filed with the Securities and Exchange Commission on March 28, 2002).
- 3.1.4 Certificate of Amendment to Mattersight Corporation's Certificate of Incorporation effective May 31, 2011 (incorporated by reference to Exhibit 3.1 to Mattersight Corporation's Current Report on Form 8-K (File No. 000-27975) as filed with the Securities and Exchange Commission on May 31, 2011).
- 3.2.1 By-Laws of Mattersight Corporation (incorporated by reference to Exhibit 3.2 to Amendment No. 1 to Mattersight Corporation's Registration Statement on Form S-1 (File No. 333-94293) as filed with the Securities and Exchange Commission on February 1, 2000).
- 3.2.2 Amendment to By-Laws of Mattersight Corporation (incorporated by reference to Exhibit 3.1 to Mattersight Corporation's Current Report on Form 8-K (File No. 000-27975) as filed with the Securities and Exchange Commission on November 16, 2007).
- 4.1 Reference is made to Exhibits 3.1.1, 3.1.2, 3.1.3, 3.1.4, 3.2.1 and 3.2.2 hereof.
- 4.2 Certificate of Designations of 7% Series B Convertible Preferred Stock of Mattersight Corporation, filed December 19, 2001 (incorporated by reference to Exhibit 3.6 to Mattersight Corporation's Annual Report on Form 10-K (File No. 000-27975) as filed with the Securities and Exchange Commission on March 28, 2002).
- 10.1 Loan and Security Agreement between Mattersight Corporation and Hercules Capital, Inc., dated August 1, 2016 (incorporated by reference to Exhibit 10.1 to Mattersight Corporation's Current Report on Form 8-K (File No. 000-27975) as filed with the Securities and Exchange Commission on August 5, 2016).
- 10.2 Warrant Agreement between Mattersight Corporation and Hercules Capital, Inc., dated August 1, 2016 (incorporated by reference to Exhibit 10.2 to Mattersight Corporation's Current Report on Form 8-K (File No. 000-27975) as filed with the Securities and Exchange Commission on August 5, 2016).
- \*\*31.1 Certification of Kelly D. Conway under Section 302 of the Sarbanes-Oxley Act of 2002.
- \*\*31.2 Certification of David R. Gustafson under Section 302 of the Sarbanes-Oxley Act of 2002.
- \*\*32.1 Certification of Kelly D. Conway and David R. Gustafson under Section 906 of the Sarbanes-Oxley Act of 2002.
- \*\*101 The following materials from our Quarterly Report on Form 10-Q for the quarter ended September 30, 2016 are formatted in eXtensible Business Reporting Language (XBRL): (i) Consolidated Balance Sheets as of



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September 30, 2016 and December 31, 2015, (ii) Consolidated Statements of Operations for the three months and nine months ended September 30, 2016 and September 30, 2015, (iii) Consolidated Statements of Comprehensive Loss for the three months and nine months ended September 30, 2016 and September 30, 2015, (iv) Consolidated Statements of Cash Flows for the nine months ended September 30, 2016 and September 30, 2015, and (v) Notes to the Unaudited Consolidated Financial Statements.

\*\* Filed herewith.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on November 9, 2016.

MATTERSIGHT CORPORATION

By /s/ DAVID R. GUSTAFSON  
David R. Gustafson  
Interim Chief Financial Officer,

Executive Vice President and

Chief Operating Officer  
(Duly authorized signatory and  
Principal Financial Officer)

By /s/ ROSE CAMMARATA  
Rose Cammarata  
Vice President and Controller  
(Duly authorized signatory and  
Principal Accounting Officer)