

Mattersight Corp  
Form 10-Q  
November 05, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF  
1934  
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2015

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF  
1934  
FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

Commission File Number 0-27975

Mattersight Corporation

(Exact Name of Registrant as Specified in Its Charter)

Delaware 36-4304577  
(State or Other Jurisdiction of (I.R.S. Employer  
Incorporation or Organization) Identification No.)

200 W. Madison Street

Suite 3100

Chicago, Illinois 60606

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(Address of Registrant's 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, 2015 was 25,807,734.

## TABLE OF CONTENTS

|  | Page |
|--|------|
| <u>Part I. Financial Information</u>   |      |
| Item 1. <u>Financial Statements (unaudited)</u>  | 1    |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 16   |
| Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>                            | 27   |
| Item 4. <u>Controls and Procedures</u>   | 27   |
| <u>Part II. Other Information</u>  |      |
| Item 1. <u>Legal Proceedings</u>   | 27   |
| Item 1A. <u>Risk Factors</u>   | 27   |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>                           | 28   |
| Item 6. <u>Exhibits</u>  | 28   |
| <u>Signatures</u>  | 29   |

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## Part I. Financial Information

## Item 1. Financial Statements

## MATTERSIGHT CORPORATION

## CONDENSED CONSOLIDATED BALANCE SHEETS

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

|  | September 30, | December 31, |
|--|---------------|--------------|
|  | 2015          | 2014         |
| <b>ASSETS:</b>   |               |              |
| Current Assets:  |               |              |
| Cash and cash equivalents  | \$ 21,120     | \$ 14,238    |
| Receivables (net of allowances of \$19 and \$17, respectively)                             | 3,826         | 3,460        |
| Prepaid expenses   | 4,953         | 4,449        |
| Other current assets   | 475           | 236          |
| Total current assets   | 30,374        | 22,383       |
| Equipment and leasehold improvements, net  | 7,901         | 4,657        |
| Goodwill   | 972           | 972          |
| Intangibles, net   | 3,399         | 571          |
| Other long-term assets   | 2,630         | 3,495        |
| Total assets   | \$ 45,276     | \$ 32,078    |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY:</b>   |               |              |
| Current Liabilities:   |               |              |
| Accounts payable   | \$ 1,968      | \$ 1,183     |
| Accrued compensation and related costs   | 2,451         | 2,241        |
| Unearned revenue   | 8,143         | 7,859        |
| Capital leases   | 1,694         | 1,637        |
| Other current liabilities  | 1,308         | 2,549        |
| Total current liabilities  | 15,564        | 15,469       |
| Long-term unearned revenue   | 1,796         | 2,532        |
| Long-term capital leases   | 1,495         | 1,176        |
| Other long-term liabilities  | 5,483         | 282          |
| Total liabilities  | 24,338        | 19,459       |
| Series B Stock, \$0.01 par value; 5,000,000 shares authorized and designated;<br>1,644,768 |               |              |
| and 1,648,185 shares issued and outstanding, with a liquidation preference of<br>\$10,297  |               |              |
| and \$9,877, at September 30, 2015 and December 31, 2014, respectively                     | 8,388         | 8,406        |
| <b>Stockholders' Equity:</b>   |               |              |
| Preferred Stock, \$0.01 par value; 35,000,000 shares authorized; none issued and           | —             | —            |

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|  |            |            |
|--|------------|------------|
| outstanding  |            |            |
| Common Stock, \$0.01 par value; 50,000,000 shares authorized; 27,635,973 and<br>24,046,977 shares issued and 25,807,547 and 22,324,093 shares outstanding at |            |            |
| September 30, 2015 and December 31, 2014, respectively   | 276        | 240        |
| Additional paid-in capital   | 263,608    | 243,282    |
| Accumulated deficit  | (237,724 ) | (226,404 ) |
| Treasury stock, at cost, 1,828,426 and 1,722,884 shares at September 30, 2015 and<br>December 31, 2014, respectively   | (9,584 )   | (8,879 )   |
| Accumulated other comprehensive loss   | (4,026 )   | (4,026 )   |
| Total stockholders' equity   | 12,550     | 4,213      |
| Total liabilities and stockholders' equity   | \$ 45,276  | \$ 32,078  |

See accompanying notes to the Condensed Consolidated Financial Statements.

## MATTERSIGHT CORPORATION

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited and in thousands, except per share data)

|   | For the Three Months<br>Ended |                       | For the Nine Months<br>Ended |                       |
|---|-------------------------------|-----------------------|------------------------------|-----------------------|
|   | September 30,<br>2015         | September 30,<br>2014 | September 30,<br>2015        | September 30,<br>2014 |
| <b>Revenue:</b>   |                               |                       |                              |                       |
| Subscription revenue  | \$ 9,313                      | \$ 6,636              | \$ 26,519                    | \$ 18,996             |
| Other revenue   | 1,169                         | 1,044                 | 3,021                        | 3,037                 |
| Total revenue   | 10,482                        | 7,680                 | 29,540                       | 22,033                |
| <b>Operating expenses:</b>  |                               |                       |                              |                       |
| Cost of Subscription revenue  | 1,930                         | 1,719                 | 5,853                        | 5,163                 |
| Cost of Other revenue   | 609                           | 680                   | 1,930                        | 1,730                 |
| Total cost of revenue, exclusive of depreciation and<br>amortization shown below: | 2,539                         | 2,399                 | 7,783                        | 6,893                 |
| Research and development  | 3,397                         | 3,240                 | 10,185                       | 9,613                 |
| Sales and marketing   | 3,773                         | 2,388                 | 10,016                       | 6,693                 |
| General and administrative  | 3,108                         | 2,320                 | 8,811                        | 6,851                 |
| Depreciation and amortization   | 1,236                         | 792                   | 3,347                        | 2,272                 |
| Total operating expenses  | 14,053                        | 11,139                | 40,142                       | 32,322                |
| Operating loss  | (3,571 )                      | (3,459 )              | (10,602 )                    | (10,289 )             |
| Interest and other expense, net   | (331 )                        | (711 )                | (690 )                       | (1,021 )              |
| Change in fair value of warrant liability   | (22 )                         | (5 )                  | 3                            | (91 )                 |
| Loss before income taxes  | (3,924 )                      | (4,175 )              | (11,289 )                    | (11,401 )             |
| Income tax provision  | (15 )                         | (7 )                  | (31 )                        | (24 )                 |
| Net loss  | (3,939 )                      | (4,182 )              | (11,320 )                    | (11,425 )             |
| Dividends related to Series B Stock   | (147 )                        | (147 )                | (441 )                       | (441 )                |
| Net loss available to Common Stock holders  | \$ (4,086 )                   | \$ (4,329 )           | \$ (11,761 )                 | \$ (11,866 )          |
| <b>Per share of Common Stock:</b>   |                               |                       |                              |                       |
| Basic net loss available to Common Stock holders                                  | \$ (0.17 )                    | \$ (0.21 )            | \$ (0.52 )                   | \$ (0.61 )            |
| Diluted net loss available to Common Stock holders                                | \$ (0.17 )                    | \$ (0.21 )            | \$ (0.52 )                   | \$ (0.61 )            |
| Shares used to calculate basic net loss per share                                 | 24,185                        | 20,790                | 22,698                       | 19,324                |
| Shares used to calculate diluted net loss per share                               | 24,185                        | 20,790                | 22,698                       | 19,324                |
| Stock-based compensation, primarily restricted stock, is<br>included              |                               |                       |                              |                       |
| in individual line items above:   |                               |                       |                              |                       |
| Total cost of revenue   | \$ 63                         | \$ 40                 | \$ 187                       | \$ 142                |
| Research and development  | 294                           | 376                   | 813                          | 1,127                 |
| Sales and marketing   | 391                           | 252                   | 1,112                        | 663                   |
| General and administrative  | 728                           | 499                   | 2,146                        | 1,472                 |

See accompanying notes to the Condensed Consolidated Financial Statements.

MATTERSIGHT CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(Unaudited and in thousands)

|                                | For the Three<br>Months<br>Ended<br>September |             | For the Nine Months<br>Ended<br>September |              |
|--------------------------------|---|-------------|---|--------------|
|                                | 30,<br>2015                                   | 30,<br>2014 | 30,<br>2015                               | 30,<br>2014  |
| Net loss                       | \$ (3,939)                                    | \$ (4,182 ) | \$ (11,320)                               | \$ (11,425 ) |
| Other comprehensive loss:      |   |             |   |              |
| Effect of currency translation | (2 )  | 2           | —   | 5            |
| Comprehensive net loss         | \$ (3,941)                                    | \$ (4,180 ) | \$ (11,320)                               | \$ (11,420 ) |

See accompanying notes to the Condensed Consolidated Financial Statements.



## MATTERSIGHT CORPORATION

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited and in thousands)

|   | For the Nine Months<br>Ended |               |
|---|------------------------------|---------------|
|   | September 30,                | September 30, |
|   | 2015                         | 2014          |
| <b>Cash Flows from Operating Activities:</b>                                |                              |               |
| Net loss  | \$(11,320)                   | \$ (11,425 )  |
| Adjustments to reconcile net loss to net cash used in operating activities: |                              |               |
| Depreciation and amortization   | 3,347                        | 2,272         |
| Stock-based compensation  | 4,258                        | 3,404         |
| Change in fair value of warrant liability                                   | (3 )                         | 91            |
| Changes in assets and liabilities:  |                              |               |
| Receivables   | (366 )                       | (376 )        |
| Prepaid expenses  | (957 )                       | 265           |
| Other assets  | 727                          | 213           |
| Accounts payable  | 75                           | 250           |
| Accrued compensation and related costs                                      | 210                          | 153           |
| Unearned revenue  | (452 )                       | 1,424         |
| Other liabilities   | 1,656                        | 188           |
| Total Adjustments   | 8,495                        | 7,884         |
| Net cash used in operating activities                                       | (2,825 )                     | (3,541 )      |
| <b>Cash Flows from Investing Activities:</b>                                |                              |               |
| Capital expenditures  | (3,654 )                     | (647 )        |
| Intangible assets   | (660 )                       | (199 )        |
| Net cash used in investing activities                                       | (4,314 )                     | (846 )        |
| <b>Cash Flows from Financing Activities:</b>                                |                              |               |
| Proceeds from issuance of Common Stock, net                                 | 15,942                       | 11,138        |
| Proceeds from line of credit  | 15,000                       | 7,000         |
| Repayments from line of credit  | (15,000)                     | (7,000 )      |
| Principal payments under capital lease obligations                          | (1,552 )                     | (1,226 )      |
| Acquisition of treasury stock, net  | (753 )                       | (718 )        |
| Proceeds from stock compensation and employee stock purchase plans, net     | 383                          | 123           |
| Net cash provided by financing activities                                   | 14,020                       | 9,317         |
| Effect of exchange rate changes on cash and cash equivalents                | 1                            | (7 )          |
| Increase in cash and cash equivalents                                       | 6,882                        | 4,923         |
| Cash and cash equivalents, beginning of period                              | 14,238                       | 13,392        |
| Cash and cash equivalents, end of period                                    | \$21,120                     | \$ 18,315     |
| <b>Non-Cash Investing and Financing Transactions:</b>                       |                              |               |
| Capital lease obligations incurred  | \$2,002                      | \$ 1,044      |
| Capital equipment purchased on credit                                       | 2,002                        | 1,044         |
| Fair value of warrants classified as liability                              | —                            | 326           |

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|  |       |        |
|--|-------|--------|
| Fair value of intellectual property purchase liability | 2,123 | —      |
| Supplemental Disclosures of Cash Flow Information:     |       |        |
| Interest paid  | \$155 | \$ 211 |

See accompanying notes to the Condensed Consolidated Financial Statements.

MATTERSIGHT CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note One — General

In the opinion of management, the accompanying unaudited condensed consolidated financial statements of Mattersight Corporation (“we,” “Mattersight,” or the “Company”) include all normal and recurring adjustments necessary for a fair presentation of our condensed consolidated financial position as of September 30, 2015 and December 31, 2014, the condensed consolidated results of our operations for the three months and nine months ended September 30, 2015 and September 30, 2014, the condensed consolidated statements of our comprehensive loss for the three months and nine months ended September 30, 2015 and September 30, 2014, and our condensed consolidated cash flows for the nine months ended September 30, 2015 and September 30, 2014, and are in accordance with United States generally accepted accounting principles (“GAAP”) and in conformity with Securities and Exchange Commission (“SEC”) Article 8-03 of Regulation S-X; provided, that certain information and disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted.

The accompanying unaudited condensed 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 fiscal year ended December 31, 2014 filed with the SEC on March 12, 2015. The results of operations for the three months and nine months ended September 30, 2015 are not necessarily indicative of the results to be expected for the full year.

The preparation of financial statements in conformity with GAAP requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Note Two — Summary of Significant Accounting Policies

For a description of the Company’s Summary of Significant Accounting Policies, see Note Two “Summary of Significant Accounting Policies” of the “Notes to Consolidated Financial Statements” included in our Annual Report on Form 10-K for the year ended December 31, 2014.

Change in Presentation

Beginning in the second quarter of 2015, Mattersight reclassified certain expenses, which had been previously reported within Selling, marketing and development, to distinguish between (i) Research and development and (ii) Sales and marketing.

In the first quarter of 2015, Mattersight began to report Subscription revenue, which consists of Behavioral Analytics Subscription revenue and Marketing Managed Services revenue, and Other revenue, which consists of Deployment revenue, Professional Services revenue, CRM Services revenue, and Reimbursed Expenses revenue. Previously, in 2014 Mattersight reported Behavioral Analytics revenue, which consisted of Subscription revenue, Deployment revenue, and Professional Services revenue, and Other revenue, which consisted of CRM Services revenue and Marketing Managed Services revenue. Reimbursed Expenses revenue was reported separately.

We feel the revised presentation provides a clearer understanding of our business and revenue streams. The changes in presentation did not have an impact on total revenue, total cost of revenue, or total operating expenses. There was no change to our significant accounting policies. The 2014 revenue and expense classifications have been revised to conform to our current presentation.

### Note Three — Revenue Recognition

#### Revenue Recognition

##### Subscription Revenue

Subscription revenue consists of Subscription revenue derived from Mattersight's Behavioral Analytics service offerings, including Predictive Behavioral Routing, Performance Management, Quality Assurance, and Predictive Analytics and Marketing Managed Services revenue derived from the performance of services on a continual basis.

Subscription revenue is based on a number of factors, such as the number of users to whom the Company provides one or more of its Behavioral Analytics offerings, the type and number of Behavioral Analytics offerings deployed to the client, and in

some cases, the number of hours of calls analyzed during the relevant month of the subscription period. Subscription periods generally range from three to five years after the go-live date or, in cases where the Company contracts with a client for a short-term pilot of a Behavioral Analytics offering prior to committing to a longer subscription period, if any, the subscription or pilot periods generally range from three to twelve months after the go-live date. This revenue is recognized over the applicable subscription period, as the service is performed for the client.

#### Other Revenue

Other revenue consists of Deployment revenue, Professional Services revenue, and Reimbursed Expenses revenue.

Deployment revenue consists of planning, deployment, and training fees derived from Behavioral Analytics contracts. These fees, which are considered to be installation fees related to Behavioral Analytics subscription contracts, are deferred until the installation is complete and are then recognized over the applicable subscription period. In cases where the Company contracts with a client for a short-term pilot of a Behavioral Analytics offering prior to committing to a longer subscription period, if any, the period in which pilot deployment revenue is recognized generally ranges from three to twelve months after the go-live date. Installation costs incurred are deferred up to an amount not to exceed the amount of deferred installation revenue and additional amounts that are recoverable based on the contractual arrangement. These costs are included in Prepaid expenses and Other long-term assets. Such costs are amortized over the subscription period. Costs in excess of the foregoing revenue amount are expensed in the period incurred.

Professional Services revenue primarily consists of fees charged to the Company’s clients to provide post-deployment follow-on consulting services, which include custom data analysis, the implementation of enhancements, and training, as well as fees generated from the Company’s operational consulting services. Professional Services are performed for the Company’s clients on a fixed-fee or time-and-materials basis. Revenue is recognized as the services are performed, with performance generally assessed on the ratio of actual hours incurred to-date compared to the total estimated hours over the entire term of the contract.

Reimbursed Expenses revenue includes billable costs related to travel and other out-of-pocket expenses incurred while performing services for the Company’s clients. The cost of third-party product and support may be included within this category if the transaction does not satisfy the requirements for gross reporting. An equivalent amount of reimbursable expenses is included in Total cost of revenue.

#### Note Four — Stock-Based Compensation

The Company has two stock-based compensation plans, the Mattersight Corporation 1999 Stock Incentive Plan (the “1999 Plan”) and the Mattersight Corporation Employee Stock Purchase Plan (the “ESPP”), each as described more fully in Note Thirteen in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014.

| For the Three Months Ended |               | For the Nine Months Ended |               |
|----------------------------|---------------|---------------------------|---------------|
| September 30,              | September 30, | September 30,             | September 30, |
| 2015                       | 2014          | 2015                      | 2014          |

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Stock-based compensation expense (in millions) \$ 1.5 \$ 1.2 \$ 4.3 \$ 3.4

The Company recognizes stock-based compensation expense on a straight-line basis over the vesting period. The Company has established its forfeiture rate based on historical experience.

As of September 30, 2015, there were a total of 1,830,124 shares of the Company's common stock, par value \$0.01 per share ("Common Stock"), available for future grants under the 1999 Plan and from treasury stock. The Common Stock is traded on the NASDAQ Global Market under the symbol "MATR".

6

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## Restricted Stock

Restricted stock award activity was as follows for the nine months ended September 30, 2015:

|  | Shares    | Weighted<br>Average<br>Price |
|--|-----------|------------------------------|
| Unvested balance at December 31, 2014  | 556,194   | \$ 5.76                      |
| Granted                                | 778,606   | \$ 6.72                      |
| Vested                                 | (424,417) | \$ 6.20                      |
| Forfeited                              | (46,052 ) | \$ 6.19                      |
| Unvested balance at September 30, 2015 | 864,331   | \$ 6.38                      |

| (In millions)   | For the Three Months Ended |                       | For the Nine Months Ended |                       |
|---|----------------------------|-----------------------|---------------------------|-----------------------|
|   | September 30,<br>2015      | September 30,<br>2014 | September 30,<br>2015     | September 30,<br>2014 |
| Total fair value of restricted stock awards vested      | \$ 0.4                     | \$ 0.3                | \$ 2.8                    | \$ 2.2                |
| Compensation expense related to restricted stock awards | 0.6                        | 0.4                   | 1.9                       | 1.3                   |

As of September 30, 2015, there remained \$4.2 million of unrecognized compensation expense related to restricted stock awards. These costs are expected to be recognized over a weighted average period of 1.9 years.

## Stock Options

During the nine months ended September 30, 2015, the Company granted options to purchase a total of 222,625 shares. During the three months ended September 30, 2015, the Company did not issue any options.

During the three months ended June 30, 2015, the Company granted options to purchase a total of 100,000 shares of Common Stock to the Board of Directors and one non-executive employee. On May 15, 2015, the Company's Board of Directors received options to purchase 70,000 shares of Common Stock. The exercise price per share is \$6.13, the closing price for shares of Common Stock on May 15, 2015, the grant date. The options vested 25% on May 31, 2015, with the balance vesting ratably over the following three quarters. The options expire on May 15, 2025. On June 15, 2015, one non-executive employee received options to purchase 30,000 shares of Common Stock. The exercise price per share is \$6.24, the closing price for shares of Common Stock on June 15, 2015, the grant date. The options will vest 25% on May 31, 2016, with the balance vesting ratably over the following 12 quarters. The options expire on June 15, 2025.

During the three months ended March 31, 2015, the Company granted options to purchase a total of 122,625 shares of Common Stock to non-executive employees. The exercise price per share is \$6.90, the closing price for shares of Common Stock on February 11, 2015, the grant date. Certain of the options vested 6.25% on February 28, 2015, with

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the balance vesting ratably over the following 15 quarters, whereas others will vest 25% on February 28, 2016, with the balance vesting ratably over the following 12 quarters. The options expire on February 11, 2025.

Option activity was as follows for the nine months ended September 30, 2015:

|   | Options    | Weighted<br>Average<br>Exercise<br>Price |
|---|------------|--|
| Outstanding as of December 31, 2014                             | 2,636,596  | \$ 7.42                                  |
| Granted   | 222,625    | \$ 6.57                                  |
| Exercised   | (47,616 )  | \$ 4.71                                  |
| Forfeited   | (165,191 ) | \$ 6.61                                  |
| Outstanding as of September 30, 2015                            | 2,646,414  | \$ 7.45                                  |
| Exercisable as of September 30, 2015                            | 1,844,946  | \$ 8.23                                  |
| Outstanding intrinsic value at September 30, 2015 (in millions) | \$5.0      |  |
| Exercisable intrinsic value at September 30, 2015 (in millions) | \$3.3      |  |

7

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|   | For the Three Months Ended |               | For the Nine Months Ended |               |
|---|----------------------------|---------------|---------------------------|---------------|
|   | September 30,              | September 30, | September 30,             | September 30, |
| (In millions)                                 | 2015                       | 2014          | 2015                      | 2014          |
| Compensation expense related to option awards | \$ 0.4                     | \$ 0.4        | \$ 1.3                    | \$ 1.0        |

|  | For the Three Months Ended |               | For the Nine Months Ended |               |
|--|----------------------------|---------------|---------------------------|---------------|
|  | September 30,              | September 30, | September 30,             | September 30, |
| (In millions)                              | 2015                       | 2014          | 2015                      | 2014          |
| Total fair value of stock options vested   | \$ 0.4                     | \$ 0.4        | \$ 1.2                    | \$ 1.0        |
| Intrinsic value of stock options exercised | \$ —                       | \$ —          | \$ 0.1                    | \$ —          |
| Proceeds received from option exercises    | \$ —                       | \$ —          | \$ 0.2                    | \$ —          |

As of September 30, 2015, there remained \$2.4 million of unrecognized compensation expense related to stock options. These costs are expected to be recognized over a weighted average period of 1.7 years.

The fair value of options granted during the nine months ended September 30, 2015 and September 30, 2014 was estimated on the grant date using a Black-Scholes option-pricing model. The following assumptions represent the year-to-date weighted average for all options granted:

|                          | For the Nine Months Ended |      |               |      |
|--------------------------|---------------------------|------|---------------|------|
|                          | September 30,             |      | September 30, |      |
|                          | 2015                      | 2014 | 2015          | 2014 |
| Risk-free interest rates | 1.03                      | %    | 1.36          | %    |
| Expected dividend yield  | —                         |      | —             |      |
| Expected volatility      | 58                        | %    | 65            | %    |
| Expected lives           | 6 years                   |      | 6 years       |      |

Historical Company information is the primary basis for the selection of expected life, expected volatility, and expected dividend yield assumptions. The risk-free interest rate is selected based on the yields from U.S. Treasury Strips with a remaining term equal to the expected term of the options being valued.

#### Other Stock Compensation

##### Employee Stock Purchase Plan

The ESPP is intended to qualify as an “employee stock purchase plan” under section 423 of the Internal Revenue Code. Under the ESPP, eligible employees are permitted to purchase shares of Common Stock at below-market prices. The purchase period opens on the first day and ends on the last business day of each calendar quarter. The shares of Common Stock issued in respect of employee purchases under the ESPP were as follows:

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|  | For the Three Months Ended |               | For the Nine Months Ended |               |
|--|----------------------------|---------------|---------------------------|---------------|
|  | September 30,              | September 30, | September 30,             | September 30, |
|  | 2015                       | 2014          | 2015                      | 2014          |
| Shares of Common Stock issued          | 11,387                     | 8,212         | 32,379                    | 25,247        |
| Expense related to ESPP (in thousands) | \$ 14                      | \$ 10         | \$ 46                     | \$ 32         |

The fair value of ESPP purchases for the nine months ended September 30, 2015 and September 30, 2014 was estimated using a Black-Scholes pricing model. The Company used the following year-to-date weighted average assumptions:

|                          | For the Nine Months Ended |   |               |   |
|--------------------------|---------------------------|---|---------------|---|
|                          | September 30,             |   | September 30, |   |
|                          | 2015                      |   | 2014          |   |
| Risk-free interest rates | 0.01                      | % | 0.05          | % |
| Expected dividend yield  | —                         |   | —             |   |
| Expected volatility      | 37                        | % | 44            | % |
| Expected lives           | 0.25 years                |   | 0.25 years    |   |

## Note Five — Current Prepaid Expenses

Current prepaid expenses primarily consist of deferred costs and prepaid commissions related to Behavioral Analytics contracts. These costs are recognized over the subscription periods of the respective contracts, generally three to five years after the go-live date or, in cases where the Company contracts with a client for a short-term pilot of a Behavioral Analytics offering prior to committing to a longer subscription period, if any, the subscription or pilot periods generally range from three to twelve months after the go-live date. Costs included in current prepaid expenses will be recognized within the next twelve months.

Current prepaid expenses consisted of the following:

| (In millions)       | As of              |                   |
|---------------------|--------------------|-------------------|
|                     | September 30, 2015 | December 31, 2014 |
| Deferred costs      | \$ 1.6             | \$ 1.4            |
| Prepaid commissions | 1.5                | 1.5               |
| Other               | 1.9                | 1.6               |
| Total               | \$ 5.0             | \$ 4.5            |

## Note Six — Intangible Assets, net

Intangible assets reflect costs related to patent and trademark applications, Marketing Managed Services customer relationships, and the purchase of certain intellectual property rights in 2015. The costs related to patent and trademark applications and the purchase of certain intellectual property are amortized over 120 months. The other intangible assets are fully amortized. Amortization expense of intangible assets for the three months and nine months ended September 30, 2015 was \$0.1 million and \$0.4 million, respectively, and will be \$0.5 million annually thereafter. Amortization expense of intangible assets for the three months and nine months ended September 30, 2014 was less than \$0.1 million.

| (In millions)                                 | As of              |                   |
|---|--------------------|-------------------|
|   | September 30, 2015 | December 31, 2014 |
| Gross intangible assets                       | \$ 6.6             | \$ 3.4            |
| Accumulated amortization of intangible assets | (3.2)              | (2.8)             |
| Total   | \$ 3.4             | \$ 0.6            |

## Note Seven — Equipment and Leasehold Improvements

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Equipment and leasehold improvements consist of the following:

|   | As of         |              |
|---|---------------|--------------|
|   | September 30, | December 31, |
|   | 2015          | 2014         |
| (In millions)                               |               |              |
| Computers and software                      | \$ 19.0       | \$ 15.8      |
| Furniture and equipment                     | 0.3           | 0.5          |
| Leasehold improvements                      | 3.2           | 1.0          |
| Equipment and leasehold improvements, gross | 22.5          | 17.3         |
| Accumulated depreciation and amortization   | (14.6)        | (12.6)       |
| Equipment and leasehold improvements, net   | \$ 7.9        | \$ 4.7       |

## Note Eight — Other Long-Term Assets

Other long-term assets primarily consist of deferred costs and prepaid commissions related to Behavioral Analytics. These costs are recognized over the terms of the respective contracts, generally three to five years. Costs included in long-term assets will be recognized over the remaining term of the contracts beyond the first twelve months. Other long-term assets consisted of the following:

| (In millions)                 | As of              |                   |
|-------------------------------|--------------------|-------------------|
|                               | September 30, 2015 | December 31, 2014 |
| Deferred costs                | \$ 1.0             | \$ 1.3            |
| Prepaid commissions           | 1.2                | 1.7               |
| Noncurrent deferred tax asset | 0.1                | 0.1               |
| Other                         | 0.3                | 0.4               |
| Total                         | \$ 2.6             | \$ 3.5            |

## Note Nine — Short-Term Debt

On March 10, 2015, the Company entered into a Second Amended and Restated Loan and Security Agreement with Silicon Valley Bank (the “SVB Credit Facility”). The SVB Credit Facility provides for, among other things, a maximum credit limit of \$15 million, a term through March 10, 2017, and an interest rate of prime plus 1.25%. The SVB Credit Facility additionally provides for an annual commitment fee of \$0.1 million and an early termination fee of 1.0% in the first year of its term and 0.25% thereafter, prior to maturity. There was less than \$0.1 million of interest expense for the three months and nine months ended September 30, 2015. There was less than \$0.1 million of interest expense for the three months and nine months ended September 30, 2014. The interest rate for the nine months ended September 30, 2015 was 4.5%. The Company was in compliance with all of its debt covenants under the SVB Credit Facility as of September 30, 2015. The Company has no outstanding balance under the SVB Credit Facility as of September 30, 2015.

Effective as of August 14, 2014, the Company provided written notice of its voluntary termination of the Loan and Security Agreement entered into by the Company, together with its wholly-owned subsidiaries Mattersight Europe Holding Corporation and Mattersight International Holding, Inc., as co-borrowers, and Partners for Growth IV, L.P. (“PfG”) on August 19, 2013 (the “PfG Credit Facility”). At the time of termination, there were no amounts outstanding under the PfG Credit Facility and no penalties were incurred or paid by the Company in connection with the termination. In connection with the execution of the PfG Credit Facility, the Company granted to PfG, certain affiliates of PfG, and Silicon Valley Bank, warrants to purchase shares of Common Stock (collectively, the “PfG Warrants”). See Note Fourteen — Stock Warrants for additional information.

## Note Ten — Loss Per Share

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The following table sets forth the computation of the loss and shares used in the calculation of basic and diluted loss per share:

|  | For the Three Months<br>Ended<br>September 30, |            |
|--|--|------------|
| (In millions)  | 2015   | 2014       |
| Net loss   | \$(3.9 )                                       | \$ (4.2 )  |
| Dividends related to Series B Stock <sup>(1)</sup>             | (0.2 )   | (0.1 )     |
| Net loss available to Common Stock holders                     | \$(4.1 )                                       | \$ (4.3 )  |
| Per common share:  |  |            |
| Basic/diluted net loss available to Common Stock holders       | \$(0.17 )                                      | \$ (0.21 ) |
| (In thousands)   |  |            |
| Weighted average shares of Common Stock outstanding            | 24,185   | 20,790     |
| Currently antidilutive Common Stock equivalents <sup>(2)</sup> | 2,193  | 1,878      |

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|  | For the Nine Months<br>Ended<br>September 30, |            |
|--|---|------------|
| (In millions)  | 2015  | 2014       |
| Net loss   | \$(11.3 )                                     | \$ (11.4 ) |
| Dividends related to Series B Stock <sup>(1)</sup>             | (0.5 )  | (0.5 )     |
| Net loss available to Common Stock holders                     | \$(11.8 )                                     | \$ (11.9 ) |
| Per common share:  |   |            |
| Basic/diluted net loss available to Common Stock holders       | \$(0.52 )                                     | \$ (0.61 ) |
| (In thousands)   |   |            |
| Weighted average shares of Common Stock outstanding            | 22,698  | 19,324     |
| Currently antidilutive Common Stock equivalents <sup>(2)</sup> | 2,133   | 1,982      |

(1)The Board of Directors did not declare a dividend payment on the Company's 7% Series B Convertible Preferred Stock (the "Series B Stock"), which was accrued, for each of the dividend periods from July 1, 2012 through June 30, 2015 (the aggregate amount of these dividends was approximately \$1.8 million). If the Company's Board of Directors were to declare a semi-annual cash dividend on the Series B Stock for dividend periods subsequent to July 1, 2015, each dividend payment period would be approximately \$0.3 million on the 1,644,768 shares of Series B Stock issued and outstanding as of September 30, 2015, at the cash dividend rate of \$0.1785.

(2)In periods in which there was a loss, 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 antidilutive.

Note Eleven — Leases

Capital Leases

The Company acquired \$2.0 million and \$1.0 million of computer equipment and leasehold improvements using capital leases during the first nine months of 2015 and 2014, respectively. There was \$1.7 million and \$0.8 million of depreciation on capital leases in the first nine months of 2015 and 2014, respectively. All capital leases are for a term of twenty-four, thirty, or thirty-six months.

The following is a schedule, by year, of future minimum lease payments under capital leases, together with the present value of the net minimum lease payments as of September 30, 2015:

| (In millions)                | Amount |
|------------------------------|--------|
| Year                         |        |
| 2015                         | \$ 0.4 |
| 2016                         | 1.9    |
| 2017                         | 1.1    |
| 2018                         | 0.3    |
| Total minimum lease payments | \$ 3.7 |

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|   |        |
|---|--------|
| Less: estimated executory costs         | (0.2 ) |
| Net minimum lease payments              | \$ 3.5 |
| Less: amount representing interest      | (0.3 ) |
| Present value of minimum lease payments | \$ 3.2 |

Capital leases consisted of the following:

| (In millions)            | As of              |                   |
|--------------------------|--------------------|-------------------|
|                          | September 30, 2015 | December 31, 2014 |
| Current capital leases   | \$ 1.7             | \$ 1.6            |
| Long-term capital leases | 1.5                | 1.2               |
| Total                    | \$ 3.2             | \$ 2.8            |



## Note Twelve — Other Current Liabilities

Other current liabilities consist of the following:

| (In millions)                   | As of              |                   |
|---------------------------------|--------------------|-------------------|
|                                 | September 30, 2015 | December 31, 2014 |
| Accrued vendor payable          | \$ 0.7             | \$ —              |
| Series B Stock dividend payable | —                  | 1.5               |
| Warrant liability               | —                  | 0.4               |
| Other                           | 0.6                | 0.6               |
| <b>Total</b>                    | <b>\$ 1.3</b>      | <b>\$ 2.5</b>     |

## Note Thirteen — Other Long-Term Liabilities

Other long-term liabilities consist of the following:

| (In millions)                            | As of              |                   |
|--|--------------------|-------------------|
|  | September 30, 2015 | December 31, 2014 |
| Series B Stock dividend payable          | \$ 1.9             | \$ —              |
| Intellectual property purchase liability | 1.5                | —                 |
| Facility lease liability                 | 1.8                | —                 |
| Other                                    | 0.3                | 0.3               |
| <b>Total</b>                             | <b>\$ 5.5</b>      | <b>\$ 0.3</b>     |

The Series B dividend payable as of December 31, 2014 was \$1.5 million and included in Other current liabilities.

## Note Fourteen — Stock Warrants

During the second half of fiscal year 2013, the Company granted the following warrants: (i) to PfG, a warrant to purchase up to a value of \$360,000 or 129,032 shares of Common Stock, (ii) to PfG Equity Investors, LLC, a warrant to purchase up to a value of \$28,800 or 10,322 shares of Common Stock, and (iii) to Silicon Valley Bank, a warrant to purchase up to a value of \$211,200 or 75,698 shares of Common Stock (collectively, the “PfG Warrants”). The Company received approximately \$4,000 in connection with the issuance of the PfG Warrants, which the parties agreed was fair consideration.

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On June 4, 2014, PfG elected to partially exercise its warrant by exchanging 57,196 of the 129,032 warrant shares through a cashless exercise on the terms provided in the applicable warrant agreement. As a result, the Company issued 35,862 shares of Common Stock to PfG on June 4, 2014, and 71,836 warrant shares remained exercisable as of June 30, 2015. On September 29, 2015, PfG fully exercised its remaining warrant by exchanging the 71,836 warrant shares through a cashless exercise on the terms provided in the applicable warrant agreement. As a result, the Company issued 46,689 shares of Common Stock to PfG, in full settlement of the warrant. As of September 30, 2015, there was no outstanding and exercisable balance on the warrant.

On June 4, 2014, PfG Equity Investors, LLC elected to partially exercise its warrant by exchanging 4,945 of the 10,322 warrant shares through a cashless exercise on the terms provided in the applicable warrant agreement. As a result, the Company issued 3,100 shares of Common Stock to PfG Equity Investors, LLC on June 4, 2014 and 5,377 warrants remained exercisable as of June 4, 2014. On September 29, 2015, PfG Equity Investors, LLC fully exercised its remaining warrant by exchanging the 5,377 warrant shares through a cashless exercise on the terms provided in the applicable warrant agreement. As a result, the Company issued 3,495 shares of Common Stock to PfG Equity Investors, LLC, in full settlement of the warrant. As of September 30, 2015, there was no outstanding and exercisable balance on the warrant.

On May 20, 2014, Silicon Valley Bank elected to fully exercise its warrant by exchanging 75,698 warrant shares through a cashless exercise on the terms provided in the applicable warrant agreement. As a result, the Company issued 47,404 shares of Common Stock to Silicon Valley Bank, in full settlement of the warrant. As of September 30, 2015, there was no outstanding and exercisable balance on the warrant.

The PfG Warrants, and the shares of Common Stock issued upon exercise of the PfG Warrants, have not been and will not be registered under the Securities Act of 1933, as amended, or any state securities law and were issued pursuant to an exemption from

registration provided by Section 4(2) of the Securities Act and/or Regulation D promulgated thereunder. Neither the PfG Warrants nor the shares of Common Stock issued upon exercise of the PfG Warrants may be subsequently offered or sold within the United States absent registration or exemption from such registration requirements and compliance with applicable state laws. The warrant liability as of September 30, 2015 was \$0 and as of December 31, 2014 was \$0.4 million.

A summary of the status of the PfG Warrants at September 30, 2015, and the changes during the nine months ended September 30, 2015, are presented in the following table:

|                                      | Shares of Common    |             |                                  |                 |
|--------------------------------------|---------------------|-------------|----------------------------------|-----------------|
|                                      | Stock, par value    |             |                                  |                 |
|                                      | \$0.01, represented | Exchange    | Expiration                       |                 |
|                                      | Date                | by Warrants | Price                            | Date            |
| Outstanding as of December 31, 2014  | —                   | 77,213      | \$2.79, subject to<br>adjustment | August 19, 2018 |
| Granted                              | —                   | —           |                                  |                 |
| Exercised                            | —                   | 77,213      |                                  |                 |
| Expired                              | —                   | —           |                                  |                 |
| Outstanding as of September 30, 2015 | —                   | —           | \$2.79, subject to<br>adjustment | August 19, 2018 |
| Exercisable as of September 30, 2015 | —                   | —           | \$2.79, subject to<br>adjustment | August 19, 2018 |

The fair value of the warrant liability was estimated using the Monte Carlo option pricing model and the following assumptions:

|  | September 30, | September 30, |   |
|--|---------------|---------------|---|
|  | 2015          | 2014          |   |
| Risk-free interest rates               | —             | 1.43          | % |
| Expected dividend yield                | —             | —             |   |
| Expected volatility                    | —             | 60            | % |
| Expected lives                         | —             | 3.9           |   |
| Weighted average grant date fair value | —             | \$ 4.50       |   |

## Note Fifteen — Segment Information

The Company operates in a single business segment, focused primarily on Behavioral Analytics.

## Note Sixteen — Fair Value Measurements

The Company reports certain assets and liabilities at fair value. Fair value is an exit price and establishes a three-tier valuation hierarchy for ranking the quality and reliability of the information used to determine fair values. The first tier, Level 1, uses quoted market prices in active markets for identical assets or liabilities. Level 2 uses inputs, other than quoted market prices for identical assets or liabilities in active markets, which are observable either directly or indirectly. Level 3 uses unobservable inputs in which there are little or no market data, and requires the entity to develop its own assumptions. 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 provides the assets and liabilities carried at fair value measured on a recurring basis as of September 30, 2015 and December 31, 2014:

| (In millions)     | Fair Value Measurements at September 30, 2015 |                                    |                                  |  |
|-------------------|---|------------------------------------|----------------------------------|--|
|                   | Using<br>Total<br>carrying<br>value<br>at     | Quoted Prices in<br>Active Markets | Other<br>Observable<br>(Level 2) | Significant<br>Unobservable<br>(Level 3) |
|                   | September 30, 2015                            |                                    |                                  |  |
| Money market fund | \$20.1  | \$ 20.1                            | \$ —                             | \$ —                                     |
| Warrant liability | \$—   | \$ —                               | \$ —                             | \$ —                                     |

|                   | Fair Value Measurements at December 31, 2014 |            |              |
|-------------------|--|------------|--------------|
|                   | Using  |            |              |
|                   | Total  |            |              |
|                   | carrying                                     |            |              |
|                   | Quoted Prices in                             | Other      | Significant  |
| value             | Active Markets                               | Observable | Unobservable |
| at                |  |            |              |
|                   | December 31, 2014                            | (Level 2)  | (Level 3)    |
| Money market fund | \$ 13.7                                      | \$ 13.7    | \$ —         |
| Warrant liability | \$ 0.4                                       | \$ —       | \$ 0.4       |

The following table represents the activity in the Company's Level 3 warrants:

| (In millions)   | Amount |
|---|--------|
| Level 3 warrants, end of period at December 31, 2014  | \$ 0.4 |
| Change in fair value of warrant liability             | —      |
| Warrant exercise                                      | (0.4 ) |
| Level 3 warrants, end of period at September 30, 2015 | \$ —   |

#### Note Seventeen — Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, accounts receivable, and accounts payable approximated their fair values as of September 30, 2015 and December 31, 2014 due to the short-term nature of these instruments.

#### Note Eighteen — Recent Accounting Pronouncements

In April 2015, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2015-05, “Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40).” The pronouncement was issued to provide guidance concerning accounting for fees in a cloud computing arrangement. The pronouncement is effective for reporting periods beginning after December 15, 2015. The adoption of ASU 2015-05 is not expected to have a material impact on the Company's condensed consolidated financial statements.

In November 2014, FASB issued ASU No. 2014-16, Derivatives and Hedging (Topic 815): Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity (“ASU 2014-16”). ASU 2014-16 does not change the current criteria in GAAP for determining when separation of certain embedded derivative features in a hybrid financial instrument is required, but clarifies how current GAAP should be interpreted in the evaluation of the economic characteristics and risks of a host contract in a hybrid financial instrument that is issued in the form of a share, reducing existing diversity in practice. The adoption of this ASU is not

expected to have a material impact on the Company's condensed consolidated financial statements.

In August 2014, FASB issued ASU No. 2014-15: Presentation of Financial Statements - Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern ("ASU 2014-15"). The update sets forth a requirement for management to evaluate whether there are conditions and events that raise substantial doubt about an entity's ability to continue as a going concern, a responsibility that did not previously exist in U.S. GAAP. The amendments included in this update require management to assess an entity's ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards. Specifically, the amendments (i) provide a definition of the term substantial doubt, (ii) require an evaluation every reporting period, including interim periods, (iii) provide principles for considering the mitigating effect of management's plans, (iv) require certain disclosures when substantial doubt is alleviated as a result of consideration of management's plans, (v) require an express statement and other disclosures when substantial doubt is not alleviated, and (vi) require an assessment for a period of one year after the date that the financial statements are issued (or available to be issued). ASU 2014-15 will be effective for the Company in fiscal year 2016. The adoption of this ASU is not expected to have a material impact on the Company's condensed consolidated financial statements.

In May 2014, FASB issued ASU No. 2014-09: Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09"). The guidance 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 in U.S. GAAP. The underlying principle of the new standard is that a business or other 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. The Company is currently evaluating the impact that this standard will have on the Company's condensed consolidated financial statements.

Note Nineteen — Capital Stock and Series B Stock

On July 22, 2015, the Company signed a definitive Common Stock Purchase Agreement (the “Purchase Agreement”) to raise approximately \$16.2 million in gross proceeds in a registered direct offering. Under the terms of the Purchase Agreement, the Company sold 2,728,712 shares of Common Stock (the “Shares”). Of the aggregate 2,728,712 Shares, 2,563,238 were sold to certain investors at a price of \$5.93 per share and 165,474 were sold to certain officers and directors (including certain of their affiliates) at a price of \$6.11 per share. The Shares represented approximately 12% of the issued and outstanding shares of Common Stock immediately prior to the execution of the Purchase Agreement. The Shares were sold pursuant to a prospectus supplement dated as of July 22, 2015, in connection with a takedown from the Company’s effective shelf registration statement on Form S-3 (File No. 333-202744), which was filed with the SEC on March 13, 2015 and declared effective by the Commission on April 8, 2015.

The aggregate proceeds that the Company received from the offering, net of fees, were approximately \$15.9 million. Proceeds from the offering are being used for general corporate and working capital purposes. Craig-Hallum Capital Group LLC, which acted as the Company’s financial advisor for the offering, received a fee of \$200,000. The offering closed on July 23, 2015.

Note Twenty — 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 directors and corporate officers 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, 2015.





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

### Background

Mattersight Corporation (together with its subsidiaries and predecessors, "Mattersight," "we," "us," or the "Company") is a pioneer in personality-based software applications. Through these applications, including Predictive Behavioral Routing, Performance Management, Quality Assurance, and Predictive Analytics which comprise our Behavioral Analytics service offerings (collectively, "Behavioral Analytics"), Mattersight captures and analyzes customer and employee interactions, employee desktop data, and other contextual information to optimally route customers to the best available employee, improve operational performance, and predict future customer and employee outcomes. Mattersight's analytics are based on millions of proprietary algorithms and the application of unique behavioral models. The Company's SaaS delivery model combines analytics in the cloud with deep customer partnerships to drive significant business value. Leading companies in the healthcare, insurance, financial services, telecommunications, cable, utilities, education, hospitality, and government industries use Mattersight's solutions.

The Company's 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, the Company's Behavioral Analytics offerings enable its 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 its Behavioral Analytics offerings, Mattersight helps its 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 fraud callers and improve authentication processes.

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

Through the sale of its services featuring these applications, the Company generates the following revenue:

- (1) Subscription revenue, which is generally recurring, annuity revenue from long-term contracts (typically three- to five-year) and pilots, which are shorter-term contracts (typically three to twelve months); and

(2) Other revenue, which is generally project-based and sold on a fixed-fee or time-and-materials basis and includes follow-on Professional Services revenue.

16

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## Types of Revenue

### Subscription & Deployment Revenue

Subscription and deployment revenue is primarily driven by the execution of new Behavioral Analytics contracts, under which we deploy and provide our proprietary Behavioral Analytics offerings on a subscription basis. Based on each client's business requirements, the client's selection of our Behavioral Analytics offerings are configured and integrated into the client's environment and then deployed in either a remote-hosted or an on-premise hosted environment. Thereafter, the Behavioral Analytics offerings are provided on a subscription basis for a period that is generally three to five years after the go-live date or, in the cases where the Company contracts with a client for a short-term pilot of a Behavioral Analytics offering prior to committing to a longer subscription period, if any, the subscription or pilot periods generally range from three to twelve months after the go-live date. The fees and costs related to the initial deployment are deferred and amortized over the subscription period. We also generate revenue from Marketing Managed Services, specifically, from hosted customer and campaign data management.

### Professional Services Revenue

Professional Services revenue primarily consists of fees charged to the Company's clients to provide post-deployment follow-on consulting services, which include custom data analysis, the implementation of enhancements, and training, as well as fees generated from the Company's operational consulting services. The Professional Services are performed for the Company's clients on a fixed-fee or time-and-materials basis. Revenue is recognized as the services are performed, with performance generally assessed on the ratio of actual hours incurred to-date compared to the total estimated hours over the entire term of the contract.

### 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 Corporate Executive Board Inc. 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 are 6 million call center seats in North America. Our estimation is that 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.

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.



## Critical Accounting Policies and Estimates

Our management's discussion and analysis of financial condition and results of operations is based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue, and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to the costs and timing of completion of client projects, our ability to collect accounts receivable, the timing and amounts of expected payments associated with cost reduction activities, and the ability to realize our net deferred tax assets, contingencies, and litigation. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect the more significant judgments and estimates used in the preparation of our condensed consolidated financial statements.

### Revenue Recognition

#### Subscription Revenue

Subscription revenue consists of Subscription revenue derived from Mattersight's Behavioral Analytics service offerings, including Predictive Behavioral Routing, Performance Management, Quality Assurance, and Predictive Analytics and Marketing Managed Services revenue derived from the performance of services on a continual basis.

Subscription revenue is based on a number of factors, such as the number of users to whom the Company provides one or more of its Behavioral Analytics offerings, the type and number of Behavioral Analytics offerings deployed to the client, and in some cases, the number of hours of calls analyzed during the relevant month of the subscription period. Subscription periods generally range from three to five years after the go-live date or, in cases where the Company contracts with a client for a short-term pilot of a Behavioral Analytics offering prior to committing to a longer subscription period, if any, the subscription or pilot periods generally range from three to twelve months after the go-live date. This revenue is recognized over the applicable subscription period, as the service is performed for the client.

#### Other Revenue

Other revenue consists of Deployment revenue, Professional Services revenue, and Reimbursed Expenses revenue.

Deployment revenue consists of planning, deployment, and training fees derived from Behavioral Analytics contracts. These fees, which are considered to be installation fees related to Behavioral Analytics subscription contracts, are deferred until the installation is complete and are then recognized over the applicable subscription period. In cases where the Company contracts with a client for a short-term pilot of a Behavioral Analytics offering prior to committing to a longer subscription period, if any, the period in which pilot deployment revenue is recognized generally ranges from three to twelve months after the go-live date. Installation costs incurred are deferred up to an amount not to exceed the amount of deferred installation revenue and additional amounts that are recoverable based on the contractual arrangement. These costs are included in Prepaid expenses and Other long-term assets. Such costs are amortized over the subscription period. Costs in excess of the foregoing revenue amount are expensed in the period incurred.

Professional Services revenue primarily consists of fees charged to the Company's clients to provide post-deployment follow-on consulting services, which include custom data analysis, the implementation of enhancements, and training as well as fees generated from the Company's operational consulting services. The Professional Services are performed for the Company's clients on a fixed-fee or time-and-materials basis. Revenue is recognized as the services are performed, with performance generally assessed on the ratio of actual hours incurred to-date compared to the total estimated hours over the entire term of the contract.

Reimbursed Expenses revenue includes billable costs related to travel and other out-of-pocket expenses incurred while performing services for the Company's clients. The cost of third-party product and support may be included within this category if the transaction does not satisfy the requirements for gross reporting. An equivalent amount of reimbursable expenses is included in Total cost of revenue.

#### Unearned Revenue

Payments received for Behavioral Analytics contracts in excess of the amount of revenue recognized for these contracts are recorded as unearned revenue until revenue recognition criteria are met.

#### Allowance for Doubtful Accounts

The Company maintains allowances for doubtful accounts for estimated losses resulting from clients not paying for unpaid or disputed invoices for contractual services provided. Additional allowances may be required if the financial condition of our clients deteriorates.

#### Stock Warrants

In accordance with ASC 480-10, Distinguishing Liabilities from Equity, the Company classified certain warrants to purchase Common Stock that do not meet the requirements for classification as equity, as liabilities. Such liabilities are initially recorded at fair value with subsequent changes in fair value recorded as a component of gain or loss on warrant liability on the condensed consolidated statements of operations in each reporting period. If these warrants subsequently meet the requirements of equity classification, the Company will reclassify the fair value to equity. Fair value of the warrants was measured using a Monte Carlo option pricing model and in applying this model certain assumptions were used. See Note Fourteen, "Stock Warrants", of the "Notes to Condensed Consolidated Financial Statements" included elsewhere in this Quarterly Report on Form 10-Q.

#### Stock-Based Compensation

Stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the vesting period. Determining fair value of stock-based awards at the grant date requires certain assumptions. The Company uses historical information as the basis for the selection of expected life, expected volatility, expected dividend yield assumptions, and anticipated forfeiture rates. The risk-free interest rate is selected based on the yields from U.S. Treasury Strips with a remaining term equal to the expected term of the options being valued.

#### Intangible Assets

Intangible assets reflect costs related to patent and trademark applications, Marketing Managed Services customer relationships and the purchase of certain intellectual property rights in 2015. The costs related to patent and trademark applications and the purchase of certain intellectual property are amortized over 120 months. The other intangible assets are fully amortized.

#### Income Taxes

We have recorded income tax valuation allowances on our net deferred tax assets to account for the unpredictability surrounding the timing of realization of our U.S. and non-U.S. net deferred tax assets due to uncertain economic conditions. The valuation allowances may be reversed at a point in time when management determines realization of these tax assets has become more likely than not, based on a return to predictable levels of profitability.

The Company uses an asset and liability approach for financial accounting and reporting of income taxes. Deferred income taxes are provided when tax laws and financial accounting standards differ with respect to the amount of income for the year, the basis of assets and liabilities and for tax loss carryforwards. The Company does not provide U.S. deferred income taxes on earnings of U.S. or foreign subsidiaries, which are expected to be indefinitely reinvested.

The Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest

benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. Significant judgment is used to determine the likelihood of the benefit. There is additional guidance on derecognition, classification, interest and penalties on income taxes, accounting in interim periods, and disclosure requirements.

#### Other Significant Accounting Policies

For a description of the Company's other significant accounting policies, see Note Two, "Summary of Significant Accounting Policies", of the "Notes to Consolidated Financial Statements" included in our Annual Report filed on Form 10-K for the year ended December 31, 2014.

#### 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, 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, 2014, 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.

### Third Quarter of 2015 Compared with Third Quarter of 2014

#### Revenue

Our total revenue increased \$2.8 million, or 36%, to \$10.5 million in the third quarter of 2015, from \$7.7 million in the third quarter of 2014. The \$2.8 million increase in total revenue in the third quarter of 2015 was primarily due to the increased subscription fees associated with the conversion of several Behavioral Analytics deployments to the subscription phase of the contract, as well as expansion of user counts in our existing client base.

Subscription revenue increased by \$2.7 million, or 40%, to \$9.3 million in the third quarter of 2015 from \$6.6 million in the third quarter of 2014. The \$2.7 million increase in Subscription revenue in the third quarter of 2015 was primarily due to the increased subscription fees associated with the conversion of several Behavioral Analytics deployments to the subscription phase of the contract, as well as expansion of user counts in our existing client base.

Other revenue increased \$0.2 million, to \$1.2 million, or 12%, in the third quarter of 2015 from \$1.0 million in the third quarter of 2014. The increase in Other revenue was primarily due to higher consulting services revenue.

The Company’s top five clients accounted for 74% of total revenue in the third quarter of 2015 and 73% of total revenue in the third quarter of 2014. The top ten clients accounted for 93% of total revenue in the third quarter of 2015 and 90% of total revenue in the third quarter of 2014. In the third quarter of 2015, three clients each accounted for 10% or more of total revenue and in the third quarter of 2014, three clients each accounted for 10% or more of total revenue. 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. In the third quarter of 2014, United HealthCare Services, Inc., Progressive Casualty Insurance Company, and HealthCare Service

Corporation accounted for 25%, 20%, 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.

## Cost of Revenue Before Reimbursed Expenses, Exclusive of Depreciation and Amortization

### Cost of Services

Cost of services primarily consists of labor costs, including salaries, fringe benefits, and incentive compensation, royalties, and other client-related third-party outside services. Cost of services excludes depreciation and amortization.

Cost of Subscription revenue was \$1.9 million, or 21% of Subscription revenue, in the third quarter of 2015, compared to \$1.7 million, or 26% of Subscription revenue, in the third quarter of 2014. The \$0.2 million increase in cost was primarily due to increased revenue and incremental personnel costs. The favorable decrease in percentage was primarily due to better leverage of our cost structure supporting our subscription clients.

Cost of Other revenue decreased \$0.1 million, to \$0.6 million, or 52% of Other revenue, in the third quarter of 2015, compared to \$0.7 million, or 65% of Other revenue, in the third quarter of 2014.

### Research and Development

Research and development expenses consist primarily of salaries, incentive compensation, commissions, and employee benefits for product development personnel. The personnel costs included in this item are net of any labor costs directly related to the generation of revenue, which are represented in Cost of services.

Research and development expenses increased \$0.2 million, or 5%, to \$3.4 million in the third quarter of 2015 from \$3.2 million in the third quarter of 2014.

### Sales and Marketing

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 \$1.4 million, or 58%, to \$3.8 million in the third quarter of 2015 from \$2.4 million in the third quarter of 2014. The increase is primarily due to higher compensation and marketing costs.

### General and Administrative

General and administrative expenses consist primarily of salaries, incentive compensation, and employee benefits for administrative personnel, as well as facilities costs, a provision for uncollectible amounts, and costs for our corporate technology infrastructure and applications.

General and administrative expenses increased \$0.8 million, or 34%, to \$3.1 million in the third quarter of 2015 from \$2.3 million in the third quarter of 2014. The \$0.8 million increase is due to higher compensation, and recruiting and legal expenses.

### Depreciation and Amortization

Depreciation and amortization increased \$0.4 million, or 56%, to \$1.2 million in the third quarter of 2015, from \$0.8 million in the third quarter of 2014. The increase is due to capital expenditures in 2015, as well as the purchase of certain intellectual property rights.

### Operating Loss

Primarily as a result of the factors described above, we experienced an operating loss of \$3.6 million in the third quarter of 2015, compared to an operating loss of \$3.5 million in the third quarter of 2014.

Interest and Other Expense, Net

Interest and other expense decreased \$0.4 million, or 53%, to \$0.3 million in the third quarter of 2015, from \$0.7 million in the third quarter of 2014. The \$0.4 million decrease was primarily related to a \$0.5 million write-off of deferred financing fees in connection with the termination of our PfG Facility effective August 14, 2014, partially offset by a \$0.1 million gain on fixed asset dispositions.

#### Change in Fair Value of Warrant Liability

The fair value of warrant liability remained constant in the third quarter of 2015 and 2014.

#### Income Tax Provision

The income tax provision was less than \$0.1 million in the third quarter of both 2015 and 2014. As of September 30, 2015, total net deferred tax assets of \$73.7 million were fully offset by a valuation allowance. The level of uncertainty in predicting when we will achieve profitability, sufficient to utilize our net U.S. and non-U.S. operating losses and realize our remaining deferred tax assets, requires that an income tax valuation allowance be recognized in the financial statements.

#### Net Loss Available to Common Stockholders

We reported net loss available to holders of Common Stock of \$4.1 million in the third quarter of 2015 compared to net loss available to holders of Common Stock of \$4.3 million in the third quarter of 2014. Accrued dividends to holders of Series B Stock were \$0.1 million in both the third quarter of 2015 and 2014. In the third quarter of 2015, there was a net loss of \$0.17 per share on a basic and diluted basis, compared to a net loss of \$0.21 per share on a basic and diluted basis in the third quarter of 2014.

#### First Nine Months of 2015 Compared with First Nine Months of 2014

##### Revenue

Our total revenue increased \$7.5 million, or 34%, to \$29.5 million in the first nine months of 2015, from \$22.0 million in the first nine months of 2014. The \$7.5 million increase in total revenue in the first nine months of 2015 was primarily due to the increased subscription fees associated with the conversion of several Behavioral Analytics deployments to the subscription phase of the contract, as well as expansion of user counts in our existing client base.

Subscription revenue increased by \$7.5 million, or 40%, to \$26.5 million in the first nine months of 2015, from \$19.0 million in the first nine months of 2014. The \$7.5 million increase in Subscription revenue in the first nine months of 2015 was primarily due to the increased subscription fees associated with the conversion of several Behavioral Analytics deployments to the subscription phase of the contract, as well as expansion of user counts in our existing client base.

Other revenue remained constant at \$3.0 million in the first nine months of both 2015 and 2014.

The Company's top five clients accounted for 74% of total revenue in the first nine months of 2015 and 75% of total revenue in the first nine months of 2014. The top ten clients accounted for 91% of total revenue in the first nine months of 2015 and 91% of total revenue in the first nine months of 2014. In the first nine months of 2015, three clients each accounted for 10% or more of total revenue and in the first nine months of 2014 four clients each accounted for 10% or more of total revenue. 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. In the first nine months of 2014, United HealthCare Services, Inc., Progressive Casualty Insurance Company, HealthCare Service Corporation, and Allstate Insurance Company accounted for 24%, 21%, 11%, and 10% 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.

#### Cost of Revenue Before Reimbursed Expenses, Exclusive of Depreciation and Amortization

## Cost of Services

Cost of services primarily consists of labor costs, including salaries, fringe benefits, and incentive compensation, royalties, and other client-related third-party outside services. Cost of services excludes depreciation and amortization.

Cost of Subscription revenue was \$5.9 million, or 22% of Subscription revenue, in the first nine months of 2015, compared to \$5.2 million, or 27% of Subscription revenue, in the first nine months of 2014. The \$0.7 million increase in cost was primarily due to increased revenue and incremental personnel costs. The favorable decrease in percentage was primarily due to better leverage of our cost structure supporting our subscription clients.

Cost of Other revenue increased \$0.2 million, to \$1.9 million, or 64% of Other revenue in the first nine months of 2015, compared to \$1.7 million, or 57% of Other revenue, in the first nine months of 2014. The increase is primarily due to higher deployment compensation costs.

#### Research and Development

Research and development expenses consist primarily of salaries, incentive compensation, commissions, and employee benefits for product development personnel. The personnel costs included in this item are net of any labor costs directly related to the generation of revenue, which are represented in Cost of services.

Research and development expenses increased \$0.6 million, or 6%, to \$10.2 million in the first nine months of 2015 from \$9.6 million in the first nine months of 2014. The \$0.6 million increase is primarily due to higher compensation and outside services costs.

#### Sales and Marketing

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 \$3.3 million, or 50%, to \$10.0 million in the first nine months of 2015 from \$6.7 million in the first nine months of 2014. The increase is primarily due to higher compensation and marketing costs.

#### General and Administrative

General and administrative expenses consist primarily of salaries, incentive compensation, and employee benefits for administrative personnel, as well as facilities costs, a provision for uncollectible amounts, and costs for our corporate technology infrastructure and applications.

General and administrative expenses increased \$1.9 million, or 29%, to \$8.8 million in the first nine months of 2015 from \$6.9 million in the first nine months of 2014. The \$1.9 million increase is due to higher compensation, and recruiting and legal expenses.

#### Depreciation and Amortization

Depreciation and amortization increased \$1.0 million, or 47%, to \$3.3 million in the first nine months of 2015, from \$2.3 million in the first nine months of 2014. The increase is due to capital expenditures in 2015, as well as the purchase of certain intellectual property rights.

#### Operating Loss

Primarily as a result of the factors described above, we experienced an operating loss of \$10.6 million in the first nine months of 2015, compared to an operating loss of \$10.3 million in the first nine months of 2014.

#### Interest and Other Expense, Net

Interest and other expense decreased \$0.3 million, or 32%, to \$0.7 million of expense in the first nine months of 2015 compared to \$1.0 million of expense in the first nine months of 2014. The \$0.3 million decrease was primarily related to a \$0.5 million write-off of deferred financing fees in connection with the termination of our PfG Facility effective August 14, 2014 partially offset by a \$0.2 million gain on fixed asset dispositions.

#### Change in Fair Value of Warrant Liability

The fair value of warrant liability remained unchanged in the first nine months of 2015 and increased \$0.1 million in the first nine months of 2014.

#### Income Tax Provision

The income tax provision was less than \$0.1 million in the first nine months of both 2015 and 2014. As of September 30, 2015, total net deferred tax assets of \$73.7 million were fully offset by a valuation allowance. The level of uncertainty in predicting when we will achieve profitability, sufficient to utilize our net U.S. and non-U.S. operating losses and realize our remaining deferred tax assets, requires that an income tax valuation allowance be recognized in the financial statements.



## Net Loss Available to Common Stockholders

We reported net loss available to holders of Common Stock of \$11.8 million in the first nine months of 2015 compared to net loss available to holders of Common Stock of \$11.9 million in the first nine months of 2014. Accrued dividends to holders of Series B Stock were \$0.4 million in the first nine months of both 2015 and 2014. In the first nine months of 2015, there was a net loss of \$0.52 per share on a basic and diluted basis, compared to a net loss of \$0.61 per share on a basic and diluted basis in the first nine months of 2014.

## Liquidity and Capital Resources

### Introduction

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. As of September 30, 2015, our principal capital resources consisted of our cash and cash equivalents balance of \$21.1 million, which includes \$0.1 million in foreign bank accounts.

The increase in cash during the first nine months of 2015 was primarily from proceeds of \$15.9 million, net of fees, received from the sale of 2,728,712 shares of Common Stock pursuant to the Common Stock Purchase Agreement executed by the Company on July 22, 2015. The increase was partially offset by the net loss before non-cash items, payment of Company bonuses, capital lease principal payments, capital expenditures, the acquisition of treasury stock, and an increase in accounts receivable.

The increase in cash during the first nine months of 2014 was primarily from proceeds of \$11.1 million, net of fees, received from the sale of 2,891,566 shares of Common Stock pursuant to the Common Stock Purchase Agreement executed by the Company on July 23, 2014 and an increase in unearned revenue. This increase was partially offset by the net loss before non-cash items, payment of Company bonuses, capital lease principal payments, capital expenditures, and the acquisition of treasury stock.

### Cash Flows from Operating Activities

Net cash used in operating activities during the first nine months of 2015 was \$2.8 million compared to cash used of \$3.5 million during the first nine months of 2014. During the first nine months of 2015, net cash used in operating activities consisted primarily of the net loss before non-cash items of \$3.7 million, an increase of \$1.0 million in prepaid expenses and an increase in net other liabilities of \$1.7 million.

During the first nine months of 2014, net cash used in operating activities consisted primarily of the net loss before non-cash items of \$5.7 million, partially offset by a \$1.4 million increase in unearned revenue.

Days Sales Outstanding (“DSO”) was 29 days at September 30, 2015, compared to 35 days at December 31, 2014, a decrease of six 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. We do not expect any significant collection issues with our clients; see “Accounts Receivable Customer Concentration” for additional information on cash collections.

### Cash Flows from Investing Activities

The Company used \$4.3 million of cash in investing activities during the first nine months of 2015 compared to \$0.8 million during the first nine months of 2014.

Capital expenditures during the first nine months of 2015 were primarily related to the purchase of computer hardware and software in addition to a one-time investment in relocating our corporate headquarters. Capital expenditures were primarily related to the purchase of computer hardware and software during the first nine months of 2014. We currently expect capital expenditures of between \$4.0 million and \$4.5 million for fiscal year 2015.

#### Cash Flows from Financing Activities

Net cash provided by financing activities was \$14.0 million during the first nine months of 2015 compared to cash provided by financing activities of \$9.3 million during the first nine months of 2014. Net cash proceeds of \$14.0 million, during the first nine months of 2015 were primarily attributable to proceeds of \$15.9 million, net of fees, received from the sale of Shares pursuant to the Common Stock Purchase Agreement, partially offset by (i) \$1.6 million of principal payments under our capital lease obligations and

(ii) \$0.8 million of cash used to acquire treasury stock to meet employee tax obligations associated with the Company's stock-based compensation programs.

Net cash proceeds of \$9.3 million during the first nine months of 2014 were primarily attributable to proceeds of \$11.1 million, net of fees, from the sale of the Shares pursuant to the Purchase Agreement, partially offset by (i) \$1.2 million of principal payments under our capital lease obligations and (ii) \$0.7 million of cash used to acquire treasury stock to meet employee tax obligations associated with the Company's stock-based compensation programs.

Historically, we have not paid cash dividends on our Common Stock, and we do not expect to do so in the future. Under the terms of its certificate of designations, our Series B Stock accrues dividends at a rate of 7% per year, payable semi-annually in January and July, if declared by the Company's Board of Directors. If not declared, unpaid dividends are cumulative and accrue at the rate of 7% per annum. The Board of Directors did not declare a dividend payment on the Series B Stock, which was accrued, for each of the dividend periods from July 1, 2012 through June 30, 2015 (the aggregate amount of these dividends was approximately \$1.8 million). Payment of future dividends on the Series B Stock will be determined by the Company's Board of Directors based on the Company's outlook and macroeconomic conditions. If the Company's Board of Directors were to declare a semi-annual cash dividend on the Series B Stock for dividend periods subsequent to July 1, 2015, the dividend payment would be approximately \$0.3 million on the 1,644,768 shares of Series B Stock issued and outstanding as of September 30, 2015. The amount of each dividend accrual will be decreased by any conversions of the Series B Stock into Common Stock, as such conversions require the Company to pay accrued but unpaid dividends at the time of conversion. Conversions of Series B Stock have been permissible at the option of the holder since June 19, 2002.

The Company expects to acquire between \$0.1 million and \$0.2 million of treasury stock during the fourth quarter of 2015 to meet employee tax obligations associated with the Company's stock-based compensation programs.

#### Liquidity

Our near-term capital resources consist of our current cash balance, together with anticipated future cash flows, financing from capital leases, and the SVB Credit Facility (see "Credit Facility" below). Our balance of cash and cash equivalents was \$21.1 million as of September 30, 2015.

We anticipate that our current unrestricted cash resources, together with operating revenue and capital lease financing, 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 March 10, 2015, the Company entered into a Second Amended and Restated Loan and Security Agreement with Silicon Valley Bank (the "SVB Credit Facility"). The SVB Credit Facility provides for, among other things, a maximum credit limit of \$15 million, a term through March 10, 2017, and an interest rate of prime plus 1.25%. The SVB Credit Facility additionally provides for an annual commitment fee of \$0.1 million and early termination fee of 1.0% in the first year of its term, and 0.25% thereafter, prior to maturity. The Company has a zero balance outstanding under the SVB Credit Facility as of September 30, 2015. The Company repaid the \$8.0 million of short-term debt outstanding on July 2, 2015. The Company was in compliance with all of its debt covenants under the SVB Credit Facility as of

September 30, 2015.

See Note Nine, "Short-Term Debt", of the "Notes to Condensed Consolidated Financial Statements" for further discussion.

#### Accounts Receivable Customer Concentration

As of September 30, 2015, two clients, United HealthCare Services, Inc. and CVS Caremark Corporation, accounted for 49% and 19% of total gross accounts receivable, respectively. Of these amounts, we have collected 47% from United HealthCare Services, Inc., and 44% from CVS Caremark Corporation through November 3, 2015. Of the total September 30, 2015 gross accounts receivable, we have collected 43% as of November 3, 2015. Because we have a high percentage of our revenue 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.

25

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### Capital Lease Obligations

Capital lease obligations were \$3.2 million as of September 30, 2015 and \$2.8 million as of December 31, 2014. We are a party to capital lease agreements with leasing companies to fund our on-going equipment requirements. We expect to incur new capital lease obligations of between \$2.5 million to \$3.0 million for fiscal year 2015 as we continue to expand our investment in the infrastructure for Behavioral Analytics.

### Contractual Obligations

Cash will also be required for operating leases and non-cancellable purchase obligations, as well as various commitments reflected as liabilities on our balance sheet as of September 30, 2015. These commitments are as follows:

| (In millions)           | Total         | Less Than     |               | More Than     |               |
|-------------------------|---------------|---------------|---------------|---------------|---------------|
|                         |               | 1 Year        | 1 – 3 Years   | 3 – 5 Years   | 5 Years       |
| Contractual Obligations | Total         | Year          | Years         | Years         | Years         |
| Letters of credit       | \$3.1         | \$3.1         | \$ —          | \$ —          | \$ —          |
| Operating leases        | 7.1           | 1.5           | 2.4           | 1.6           | 1.6           |
| Capital leases          | 3.7           | 2.0           | 1.7           | —             | —             |
| Purchase obligations    | 5.4           | 3.9           | 1.5           | —             | —             |
| <b>Total</b>            | <b>\$19.3</b> | <b>\$10.5</b> | <b>\$ 5.6</b> | <b>\$ 1.6</b> | <b>\$ 1.6</b> |

### Letters of Credit

The amounts set forth in the chart above reflect standby letters of credit issued as collateral for capital leases. Specifically, these amounts reflect the face amount of these letters of credit that expire in each period presented.

### Leases

The amounts set forth in the chart above reflect future principal, interest, and executory costs of the leases entered into by the Company for technology and office equipment, as well as office and data center space. Liabilities for the principal portion of the capital lease obligations are reflected on our balance sheet as of September 30, 2015 and December 31, 2014.

### Purchase Obligations

Purchase obligations include \$4.3 million of commitments reflected as liabilities on our balance sheet as of September 30, 2015, as well as \$1.1 million of non-cancellable obligations to purchase goods or services in the future. Purchase obligations include \$1.5 million of commitments reflected as liabilities on our balance sheet as of December 31, 2014, as well as \$0.6 million of non-cancellable obligations to purchase goods or services in the future.

### Recent Accounting Pronouncements

In April 2015, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2015-05, “Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40).” The pronouncement was issued to provide guidance concerning accounting for fees in a cloud computing arrangement. The pronouncement is effective for reporting periods beginning after December 15, 2015. The adoption of ASU 2015-05 is not expected to have a material impact on the Company’s condensed consolidated financial statements.

In November 2014, FASB issued ASU No. 2014-16, Derivatives and Hedging (Topic 815): Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity (“ASU 2014-16”). ASU 2014-16 does not change the current criteria in GAAP for determining when separation of certain embedded derivative features in a hybrid financial instrument is required, but clarifies how current GAAP should be interpreted in the evaluation of the economic characteristics and risks of a host contract in a hybrid financial instrument that is issued in the form of a share, reducing existing diversity in practice. The adoption of this ASU is not expected to have a material impact on the Company’s condensed consolidated financial statements.

In August 2014, FASB issued ASU No. 2014-15: Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern (“ASU 2014-15”). The update sets forth a requirement for management to evaluate whether there are conditions and events that raise substantial doubt about an entity’s ability to continue as a going concern, a responsibility that did not previously exist in GAAP. The amendments included in this update

require management to assess an entity's ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards. Specifically, the amendments (i) provide a definition of the term "substantial doubt", (ii) require an evaluation every reporting period, including interim periods, (iii) provide principles for considering the mitigating effect of management's plans, (iv) require certain disclosures when substantial doubt is alleviated as a result of consideration of management's plans, (v) require an express statement and other disclosures when substantial doubt is not alleviated, and (vi) require an assessment for a period of one year after the date that the financial statements are issued (or available to be issued). ASU 2014-15 will be effective for the Company in fiscal year 2016. The adoption of this ASU is not expected to have a material impact on the Company's condensed consolidated financial statements.

In May 2014, FASB issued ASU 2014-09: Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09"). The guidance 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 in GAAP. The underlying principle of the new standard is that a business or other 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. The Company is currently evaluating the impact that this standard will have on the Company's condensed consolidated financial statements.

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

There have been no material changes in market risk as of September 30, 2015 from that described in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

### Item 4. Controls and Procedures

#### Evaluation of Disclosure Controls and Procedures

Mattersight maintains disclosure controls and procedures that have been designed to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the SEC and such information is accumulated and communicated to Company management, including its principal executive officers, to allow timely decisions regarding required disclosure. The Company's Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this report, as required by Rule 13a-15 of the Exchange Act. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective.

As of the last business day of our second fiscal quarter of 2015 (i.e., June 30, 2015), our public float, as calculated in accordance with Rule 12b-2 under the Exchange Act, ("Rule 12b-2"), was greater than \$75 million. As such, we will be an accelerated filer beginning with the filing of our Quarterly Report on Form 10-Q for the first quarter of 2016 (as defined in Rule 12b-2).

#### Changes in Internal Control over Financial Reporting

There has been no change in Mattersight's internal control over financial reporting that occurred during the third quarter of 2015 that has materially affected, or is reasonably likely to materially affect, Mattersight's internal control over financial reporting.

Part II. Other Information

Item 1. Legal Proceedings

See discussion under Note Twenty “Litigation and Other Contingencies” to the Notes to the Condensed Consolidated Financial Statements included in Item 1 of Part I of this Quarterly Report on Form 10-Q, which is incorporated herein by reference.

Item 1A. Risk Factors

There have been no material changes with respect to the factors disclosed in our Annual Report on Form 10-K for the year ended December 31, 2014.

27

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

## Repurchase of Equity Securities

The following table provides information relating to the Company's purchase of shares of its Common Stock in the third quarter of 2015. All of these purchases reflect shares withheld to satisfy tax withholding obligations related to vesting of restricted stock. The Company has not adopted a Common Stock repurchase plan or program.

| Period                                 | Total<br>Number<br>of Shares<br>Purchased | Average<br>Price<br>Paid<br>Per<br>Share |
|--|---|--|
| July 1, 2015 – July 31, 2015           | —   | \$ —                                     |
| August 1, 2015 – August 31, 2015       | 8,858                                     | \$ 6.50                                  |
| September 1, 2015 – September 30, 2015 | —   | \$ —                                     |
| Total                                  | 8,858                                     | \$ 6.50                                  |

## Item 6. Exhibits

- 10.1 Executive Employment Agreement between Mattersight Corporation and Sheau-ming Ross effective July 6, 2015 (filed on July 6, 2015 as Exhibit 10.1 to Mattersight Corporation's Current Report on Form 8-K).
- 10.2 Form of Purchase Agreement dated July 22, 2015 by and between Mattersight Corporation and the purchasers named therein, (filed on July 22, 2015 as Exhibit 10.1 to Mattersight Corporation's Current Report on Form 8-K).
- \*\*31.1 Certification of Kelly D. Conway under Section 302 of the Sarbanes-Oxley Act of 2002.
- \*\*31.2 Certification of Sheau-ming K. Ross under Section 302 of the Sarbanes-Oxley Act of 2002.
- Certification of Kelly D. Conway and Sheau-ming K. Ross under Section 906 of the Sarbanes-Oxley Act of 2002.
- \*\*32.1 2002.
- \*\*101 The following materials from our Quarterly Report on Form 10-Q for the quarter ended September 30, 2015 are formatted in eXtensible Business Reporting Language (XBRL): (i) Condensed Consolidated Balance Sheets as of September 30, 2015 and December 31, 2014, (ii) Condensed Consolidated Statements of Operations for the three months and nine months ended September 30, 2015 and September 30, 2014, (iii) Condensed Consolidated Statements of Comprehensive Loss for the three months and nine months ended September 30, 2015 and September 30, 2014, (iv) Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2015 and September 30, 2014, and (v) Notes to the Unaudited Condensed Consolidated Financial Statements.

\*\* Filed herewith.

28

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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 5, 2015.

MATTERSIGHT CORPORATION

By /s/ SHEAU-MING K. ROSS  
Sheau-ming K. Ross  
Vice President and Chief Financial Officer  
(Duly authorized signatory and  
Principal Financial Officer)

By /s/ GLENN H. POLSON  
Glenn H. Polson  
Vice President of Financial Reporting  
(Duly authorized signatory and  
Principal Accounting Officer)