Mattersight Corp
Form 10-K
March 12, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2017

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 Incorporation or Organization)	(I.R.S. Employer Identification No.)

200 W. Madison Street, Suite 3100

Chicago, Illinois 60606

(Address of Registrant’s Principal Executive Offices) (Zip Code)

Registrant's telephone number, including area code: (877) 235-6925

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value $0.01 per share	NASDAQ Global Market

Securities registered pursuant to Section 12(g) of the Act: None

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Annual Report on Form 10-K or any amendment to this Annual Report on Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a small reporting company)	Smaller reporting company
Emerging growth company		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The aggregate market value of Common Stock held by non-affiliates of the registrant, based upon the closing price per share of registrant’s Common Stock on June 30, 2017, as reported by The NASDAQ Stock Market LLC, is approximately $59,458,238.

The number of shares of the registrant’s Common Stock outstanding as of March 2, 2018 was 33,218,345.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of Mattersight’s Proxy Statement for its 2018 Annual Meeting of Stockholders, to be filed with the Securities and Exchange Commission within 120 days after the end of Mattersight’s fiscal year, are incorporated herein by reference into Part III where indicated; provided, that if such Proxy Statement is not filed with the Securities and Exchange Commission within 120 days after the fiscal year end covered by this Annual Report on Form 10-K, an amendment to this Annual Report on Form 10-K shall be filed no later than the end of such 120-day period.

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PART I

PART I

Forward-Looking Statements

Statements in this Annual Report on Form 10-K that are not historical facts are “forward-looking statements” and are made pursuant to the safe harbor provisions of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). A reader can identify these forward-looking statements, because they are not limited to historical fact or they use words such as “scheduled,” “will,” “anticipate,” “project,” “estimate,” “forecast,” “goal,” “objective,” “committed,” “intend,” “continue,” “plan,” “may,” “ “expect,” “intend,” “could,” “would,” “should,” or “will likely result,” and other similar expressions, and terms of similar mean in connection with any discussion of our prospects, financial statements, business, financial condition, revenues, results of operations, or liquidity, involving 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 this Annual Report on Form 10-K for the year ended December 31, 2017, including 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;
- Cyber-attacks or other privacy or data security incidents, and failure to comply with privacy and data security regulations 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 Annual Report on Form 10-K represent our views as of the date of this report, and it should not be assumed that the statements made in this Report remain accurate as of any future date. Moreover, we assume no obligation to update forward-looking statements, except as may be required by law. In light of Regulation FD, it is our policy not to comment on earnings, financial guidance, or operations other than through press releases, publicly announced conference calls, or other means that will constitute public disclosure for purposes of Regulation FD.

Item 1. Business

Overview

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

Mattersight Corporation (formerly known as eLoyalty Corporation), a corporation organized under State of Delaware law, was incorporated May 11, 1999, as a spin-out from TSC/ECM Inc.

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

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

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

Types of Revenue

Through the sale of our services featuring these applications, we generate the following types of revenue:

Subscription Revenue

Subscription revenue consists of revenue derived from Mattersight's Behavioral Analytics service offerings, including predictive behavioral routing, performance management, quality assurance, 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 we provide one or more of our 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 one to three 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.

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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 or pilot period. 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 our 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 our operational consulting services. The professional services are performed for our 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 with 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 our clients. An equivalent amount of reimbursable expenses is included in total cost of other revenue.

Business Segments

We operate in a single business segment, focused primarily on Behavioral Analytics. Financial information concerning our business segment is included in Financial Statements and Supplementary Data Part II, Item 8 of this Annual Report on Form 10-K.

International Operations

Our services are currently delivered to clients in the United States, however prior to November 2015, we had also delivered services to a client in the United Kingdom. Our revenue is and has been recognized in our U.S. entity. Our long-lived assets are and have been predominately located in the United States and consist of equipment, software, furniture and fixtures, and leasehold improvements (net of accumulated depreciation and amortization).

Methods of Distribution

Subscription and other revenues are generated by direct contractual relationships with clients.

Intellectual Property Rights

General

Our ability to protect our software, methodologies, and other intellectual property is important to our success and our competitive position. We view as proprietary the software (including source code), algorithms, analyses, and other ideas, concepts, and developments that we create in order to provide, improve, and enhance our service offerings, as well as the work product we create in the course of providing services for clients. We seek to protect our intellectual property rights in these developments and work product by relying on a combination of patent, copyright, trademark, and trade secret law, and confidentiality and non-disclosure agreements with our employees and third parties.

Patents

As of December 31, 2017, we held forty-five U.S. patents and one European patent and have applied for over twenty patents. These patents cover a broad range of our analytics capabilities, including methods for analyzing language to assess customer personality, routing customers based on personality in real time, optimizing routing to improve agent performance, and analyzing data to improve employee performance. Our issued patents will expire between 2025 and 2036.

Trademarks

We have obtained U.S. federal trademark registration for the MATTERSIGHT word mark and our tagline “The Chemistry of Conversation”. We believe that the registration of the MATTERSIGHT word mark and tagline in the United States is material to our operations.

Licenses

A majority of our clients require that we grant to them licenses in and to the intellectual property rights associated with the work product we create in the course of providing services. In some cases, our clients require assignment of ownership in the intellectual property rights to such work product, typically where such work product incorporates their confidential information or would provide them some competitive advantage in their industry. Absent an agreement to the contrary, each assignment of ownership in intellectual property rights would result in our inability to reuse the relevant work product with other clients. As a result, it is our practice to retain the rights in the underlying core intellectual property on which such work product is based, including methodologies, workplans, and software, as well as residual know-how. If we are unable to retain such rights, it is our policy to obtain from our clients a broad license to sell service offerings using such work product to other clients.

Seasonality

We typically experience modest increases in revenue and earnings from our healthcare clients during the fourth quarter due to annual healthcare enrollment periods and increased claims processing at year-end. We also see increases in revenue from our retail clients due to the peak shopping season during the fourth quarter. Any other seasonal impact to our revenue and earnings is limited, as a significant portion of our revenue is earned through our Behavioral Analytics subscription services, which is of a recurring nature.

Clients

Highest Revenue Generating Clients:

	(Percentage of Total Revenue)		
	2017	2016	2015
Top 5 Clients	71%	73 %	73 %
Top 10 Clients	86%	87 %	89 %

Clients Accounting for 10% or More of Total Revenue:

	(Percentage of Total Revenue)		
	2017	2016	2015
United HealthCare Services, Inc.	28%	33 %	31 %
CVS Caremark Corporation	16%	15 %	13 %
TriWest Healthcare Alliance Corp	14%	9 %	2 %
Progressive Casualty Insurance Company	8 %	11 %	15 %

Clients Accounting for $1 Million or More of Total Revenue:

Year	Clients
2017	11
2016	10
2015	9

See Note Two—Summary of Significant Accounting Policies of the Notes to Consolidated Financial Statements included in Part II Item 8 of this Annual Report on Form 10-K.

Competition

Although we believe the manner in which we provide Behavioral Analytics, and our benefits, to be unique, we nonetheless operate in a highly competitive and rapidly changing market and compete with a variety of organizations that offer services that may be viewed as similar to ours. These competitive organizations include data analytics solutions providers, voice recording and voice analytic services providers and software licensors, call routing solution providers, and strategic consulting firms. We believe few competitors offer the full range and depth of services that we can provide, but they may compete with us on individual factors such as expertise, price, or capacity.

Many of our competitors have longer operating histories, more clients, longer relationships with their clients, greater brand or name recognition, and significantly greater financial, technical, marketing, and public relations resources than we do. As a result, our competitors may be in a better position to respond quickly to new or emerging technologies and changes in client requirements. They may also develop and promote their products and services more effectively than we do. New market entrants also pose a threat to our business. Existing or future competitors may develop or offer solutions that are comparable or superior to ours at a lower price.

Environmental Issues

There are no known material issues regarding our compliance with any Federal, state, or local environmental regulations.

Employees

As of December 31, 2017, we employed 281 persons, none of whom is represented by a union. We consider our employee relations to be good.

Available Information and Other

Our principal internet address is www.Mattersight.com. Our Annual, Quarterly, and Current Reports on Forms 10-K, 10-Q, and 8-K, and any amendments thereto, as well as the Forms 3, 4, and 5 beneficial ownership reports filed with respect to our stock, are made available free of charge on our website as soon as reasonably practicable after the reports have been filed with, or furnished to, the Securities and Exchange Commission (SEC). However, the information found on our website is not part of this or any other report filed by us with the SEC. These reports may also be obtained at the SEC’s public reference room at 100 F Street, N.E., Washington, D.C. 20549. Information regarding the operation of the SEC’s public reference room may be obtained by calling the SEC at (800) SEC-0330. The SEC also maintains a website at www.sec.gov that contains reports, proxy statements, and other information regarding SEC registrants, including Mattersight.

Our executive office is currently located at 200 W. Madison Street, Suite 3100, Chicago, Illinois 60606 and our main telephone number is (877) 235-6925.

Item 1A. Risk Factors

There are a number of risks and uncertainties that could adversely affect our business and our overall financial performance. In addition to the matters discussed elsewhere in this Annual Report on Form 10-K, we believe the more significant of such risks and uncertainties include the following:

We have not realized an operating profit in eighteen years and there is no guarantee that we will realize an operating profit in the foreseeable future.

As of December 31, 2017, we had an accumulated deficit of $279.4 million. We expect to continue to use cash and incur operating expenses to support our growth, including costs associated with recruiting, training, and managing our sales force, costs to develop and acquire new technology, and promotional costs associated with reaching new clients. These investments, which typically are made in advance of revenue, may not yield an offsetting increase in revenue. As a result of these factors, our future revenue and income potential is uncertain. Even if we achieve profitability, we may not be able to sustain or increase profitability on a quarterly or annual basis. Our failure to become and remain profitable would depress our value and could impair our ability to raise capital, expand our business, maintain our product development efforts, diversify our product offerings, or continue our operations. A decline in our value could also cause you to lose all or part of your investment.

Our financial results are subject to significant fluctuations because of many factors, any of which could adversely affect our stock price.

In some future periods, our operating results may be below the expectations of public market analysts and investors. In this event, the price of our publicly-traded securities may fall. Our revenue and operating results may vary significantly due to a number of factors, many of which are not in our control. We may incur an impairment of goodwill and long-lived assets if our financial results are adversely impacted by these factors and we continue to incur financial losses or our stock price declines. These factors include:

- Our ability to continue to grow our revenue and meet anticipated growth targets;
- Our ability to maintain our current relationships, and develop new relationships, with clients, service providers, and business partners;

- Unanticipated cancellations or deferrals of, or reductions in the scope of, our major Behavioral Analytics contracts;
- The length of the sales cycle associated with our solutions;
- Our ability to successfully introduce new, and upgrade our existing, service offerings for clients;
- Our ability to respond effectively to competition;
- The mix of our service offerings sold in any period;
- The cost and potential outcomes of litigation, which could have a material adverse effect on our business;
- Future accounting pronouncements or changes in our accounting policies; and
- General economic conditions.

If we are unable to address these risks, our business, results of operations, and prospects could suffer.

We depend on a limited number of clients for a significant portion of our revenue, and the loss of a significant client or a substantial decline in the size or scope of deployments for a significant client, could have a material adverse effect on our business.

We derive, and expect to continue to derive for the foreseeable future, a significant portion of our total revenue from a limited number of clients. See Clients in Part I Item 1 and 2017 Compared to 2016 included in Management's Discussion and Analysis of Financial Condition and Results of Operations in Part II Item 7 of this Annual Report on Form 10-K for more information on the portion of our total revenue derived from these clients. To the extent that any significant client uses less of our services or terminates its relationship with us, as may occur as clients respond to conditions affecting their own businesses, our total revenue could decline substantially and that could significantly harm our business. United HealthCare Services, Inc., our largest customer in 2017, has expressed an intent to use less of our services in 2018, which could have a material impact on revenue. In addition, 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 Days Sales Outstanding.

We depend on good relations with our clients, and any harm to these good relations may materially and adversely affect our business and our ability to compete effectively.

To attract and retain clients, we depend to a large extent on our relationships with our clients and our reputation for high quality analytics and related services. If a client is not satisfied with our services, it may be damaging to our reputation and business. Any defects or errors in our services or solutions or failure to meet our clients' expectations could result in:

- Delayed or lost revenue;
- Obligations to provide additional services to a client at a reduced fee or at no charge;
- Negative publicity, which could damage our reputation and adversely affect our ability to attract or retain clients; and
- Claims for damages against us, regardless of our responsibility for such failure.

If we fail to meet our contractual obligations with our clients, then we could be subject to legal liability or loss of clients. Although our contracts include provisions to limit our exposure to legal claims related to the services and solutions we provide, these provisions may not protect us, or protect us sufficiently, in all cases.

We must maintain our reputation and expand our name recognition to remain competitive.

We believe that establishing and maintaining a good reputation and brand name is critical for attracting and expanding our targeted client base and we are investing substantially in marketing in order to expand our name recognition in the marketplace for our services and solutions. If potential clients do not know the types of solutions we provide, or if our reputation is damaged, then we may become less competitive or lose our market share. Promotion and enhancement of our name and brand will depend largely on both the efficacy of our relatively nascent marketing efforts and our success in providing high quality services, software, and solutions, neither of which can be assured.

Our clients use our solutions for critical applications. If clients do not perceive our solutions to be effective or of higher quality than those available from our competitors, or if our solutions result in errors, defects, or other performance problems, then our brand name and reputation could be materially and adversely affected, we could lose potential sales and existing customers, including through early termination of our contracts, our ability to operate our business may be impaired, and our business may suffer.

Our industry is very competitive and, if we fail to compete successfully, our market share and business will be adversely affected.

We operate in a highly competitive and rapidly changing market and compete with a variety of organizations that offer services that may be viewed as similar to ours. These competitive organizations include data analytics solutions providers, voice recording and voice analytic service providers and software licensors, call routing solution providers, and strategic consulting firms. We compete with these organizations on factors such as expertise, price, and capacity.

Many of our competitors have longer operating histories, more clients, longer relationships with their clients, greater brand or name recognition, more registered patents, and significantly greater financial, technical, marketing, and public relations resources than we do. As a result, our competitors may be in a better position to respond quickly to new or emerging technologies and changes in client requirements. They may also develop and promote their products and services more effectively than we do. New market entrants also pose a threat to our business. Existing or future competitors may develop or offer solutions that are comparable or superior to ours at a lower price.

In addition, if one or more of our competitors were to merge or partner with another of our competitors, the change in the competitive landscape could adversely affect our ability to compete effectively. We may also lose clients that merge with or are acquired by companies using a competitor's offering or an internally-developed tool. If we cannot compete successfully against our current and future competitors, our business may be harmed.

We must keep pace with the rapid rate of innovation in our industry in order to build our business.

The data analytics market, and particularly behavioral analytics, is relatively new and rapidly evolving. Our future business depends in part upon continued growth in the acceptance and use of Behavioral Analytics by our current and prospective clients. Their acceptance and usage in turn may depend upon factors such as: the actual or perceived benefits of adoption of Behavioral Analytics and related methodologies and technologies, including the predictability of a meaningful return on investment, cost efficiencies, or other measurable economic benefits; the actual or perceived reliability, scalability, ease of use, and access to such new technologies and methodologies; and the willingness to adopt new business methods. Furthermore, our future growth depends on our continuing ability to innovate in the field of data analytics and to incorporate emerging industry standards.

We cannot assure that we will be successful in anticipating or responding to these challenges on a timely or competitive basis or at all, or that our ideas and solutions will be successful in the marketplace. In addition, new or disruptive technologies and methodologies by our competitors may make our service or solution offerings uncompetitive. Any of these circumstances could significantly harm our business and financial results.

Because our services and solutions are sophisticated, we must devote significant time and effort to our sales and installation processes, with significant risk of loss if we are not successful.

Because our services and solutions are not simple, mass-market items with which our potential clients are already familiar, it is necessary for us to devote significant time and effort to the process of educating our potential clients about the benefits and value of our services and solutions as part of the sales process. In addition, because our services and solutions are sophisticated and in most cases are not readily usable by clients without our assistance in integration and configuration, training, and/or analysis, we must devote significant time during the installation and subscription process in order to ensure that our services and solutions are successfully deployed. These efforts increase the time and difficulty of completing transactions, make it more difficult to efficiently deploy our limited resources, and create risk that we will have invested in an opportunity that ultimately does not come to fruition. If we are unable to demonstrate the benefits and value of our services and solutions to clients and efficiently convert our sales leads into successful sales and installations, our results of operations may be adversely affected.

A breach of security, disruption or failure of our information technology systems or those of our third-party service providers, including any perceived vulnerability therein could adversely impact our business, financial condition and results of operations.

We may be affected by software viruses or similar technology in the future, which could compromise our operations. Further, our information technology systems or the third-party systems that we interface with may be vulnerable to physical break-ins, hackers, improper employee or contractor access, programming errors, attacks by third parties or similar disruptive problems, resulting in the potential misappropriation of our proprietary information, or the confidential information of our clients, harm to our products or interruptions of our services. Any compromise of our security, whether as a result of our own information technology systems or third-party systems that they interface with, could substantially disrupt our operations, harm our reputation and reduce demand for our products and services, and in the case of breaches to the confidential or personally-identifiable data of the customers of our clients significant liability.

The unauthorized disclosure of the confidential customer data that we maintain could result in a significant loss of business and subject us to substantial liability.

In providing Behavioral Analytics, we record and analyze telephone calls and other interactions between our clients' call center and back office agents and their customers. These interactions may contain numerous references to highly sensitive confidential or personally-identifiable data of the customers of our clients, and many of our clients are required to comply with federal, state, and foreign laws concerning privacy and security, such as the Health Insurance Portability and Accountability Act of 1996 and the Gramm-Leach-Bliley Act of 1999. In addition, we have made certain contractual commitments to our clients regarding this confidential data.

In light of the highly-confidential information that we record and maintain, our clients require that we agree not to limit our liability in the event of a security breach resulting in the loss of, or unauthorized access to, personally-identifiable or other confidential data. As a result, the disclosure or loss of such data could result in the considerable diminution of our business and prospects and could subject us to substantial liability. While we have extensive security measures in place, they may be breached through third-party action, including by intentional misconduct of computer hackers, employee error or malfeasance, or otherwise and result in unauthorized access to our systems, data, proprietary information or intellectual property, or customer data.

In addition, the laws, regulations, and industry standards governing these matters are changing rapidly. It is possible that the resources we devote to comply with such laws, regulations, and industry standards, and our clients' particular requirements, could increase materially. In our contracts, we generally agree to indemnify our clients for expenses and liabilities resulting from unauthorized access to or disclosure of confidential data, such as those arising from data breach notification requirements. These indemnity obligations are generally not subject to contractual limitations on liability. As a result, the amount of liability we could incur in connection with these indemnity obligations could exceed the revenue we receive from the client under the applicable contract.

Our financial results could be adversely affected by economic and political conditions and the effects of these conditions on our clients' businesses and levels of business activity.

Economic and political conditions globally affect our clients' businesses and the markets they serve. A severe and/or prolonged economic downturn or a negative or uncertain political climate could adversely affect our clients' financial conditions and the levels of business activity of our clients and the industries we serve. This may reduce demand for our services or depress pricing of those services and have a material adverse effect on our results of operations. In addition, these economic conditions may cause our clients to delay payments for services we have provided to them, resulting in a negative impact to our cash flow. If we are unable to successfully anticipate changing economic and political conditions, then we may be unable to effectively plan for and respond to those changes, and our business could be negatively affected.

We rely heavily on our senior management team for the success of our business.

Given the highly specialized nature of our services, senior management must have a thorough understanding of our service offerings as well as the skills and experience necessary to manage the organization. If one or more members of our senior management team leaves and we cannot replace them with a suitable candidate quickly, then we could experience difficulty in managing our business properly, and this could harm our business prospects, client relationships, employee morale, and results of operations.

Our ability to recruit talented professionals and retain our existing professionals is critical to the success of our business.

We believe that our success depends substantially on our ability to attract, train, motivate, and retain highly skilled management, strategic, technical, product development, data analysis, and other key professional employees. Our business straddles the information-technology and data analytics services industries, which are people-intensive and face shortages of qualified personnel, especially those with specialized skills or experience. We compete with other companies to recruit and hire from this limited pool, particularly in Austin, Texas, the location of our product development team, and in Chicago, Illinois, the location of our data science and analytics teams.

If we cannot hire and retain qualified personnel, or if a significant number of our current employees should leave, and we have difficulty replacing such persons, then we could potentially suffer the loss of client relationships or new business opportunities and our business could be seriously harmed. In addition, there is no guarantee that the employee and client non-solicitation and non-competition agreements we have entered into with our senior professionals would deter them from departing us for our competitors or that such agreements would be upheld and enforced by a court or other arbiter across all jurisdictions where we engage in business.

We have a limited ability to protect our intellectual property rights, which are important to our success and competitive position.

Our ability to protect our software, algorithms, databases, methodologies, and other intellectual property is important to our success and our competitive position. We view as proprietary the software (including source code), algorithms, databases, analysis, and other ideas, concepts, and developments that we create in order to provide, improve, and enhance our service offerings, as well as the work product we create in the course of providing services for clients. We seek to protect our intellectual property rights in these developments and work product by applying for patents, copyrights, and trademarks, as appropriate, as well as by enforcing applicable trade secret laws and contractual restrictions on scope of use, disclosure, copying, reverse engineering, and assignment.

Despite our efforts to protect our intellectual property rights from unauthorized use or disclosure, others may attempt to disclose, obtain, or use our rights. The steps we take may not be adequate to prevent or deter infringement or other misappropriation of our intellectual property rights. In addition, we may not detect unauthorized use of, or take timely and effective actions to enforce and protect, our intellectual property rights. Furthermore, our efforts to enforce our intellectual property rights may be met with defenses, counterclaims, and countersuits attacking the validity and enforceability of our intellectual property rights or alleging that we infringe the counterclaimant's own intellectual property. Third parties may challenge the validity or ownership of our intellectual property, and these challenges could cause us to lose our rights, in whole or in part, to our intellectual property or narrow the scope of our rights such that they no longer provide meaningful protection.

We may be required to obtain licenses from others to refine, develop, market, and deliver current and new services and solutions. There can be no assurance that we will be able to obtain any of these licenses on commercially reasonable terms or at all, or that rights granted by these licenses ultimately will be valid and enforceable.

If we fail to meaningfully protect our intellectual property, our business, brand, operating results, and financial condition could be materially harmed.

Others could claim that our services, products, or solutions infringe upon their intellectual property rights or violate contractual protections.

We or our clients may be subject to claims that our services, products, or solutions, or the products of our software providers or other alliance partners, infringe upon the intellectual property rights of others. Any such infringement claims may result in substantial costs, divert management attention and other resources, harm our reputation, and prevent us from offering some services, products, or solutions. A successful infringement claim against us could materially and adversely affect our business.

In our contracts with clients, we agree to indemnify our clients for expenses and liabilities resulting from claimed infringement by our services, products, or solutions, in most cases excluding third-party components, of the intellectual property rights of others. In some instances, the amount of these indemnity obligations may be greater than the revenue we receive from the client under the applicable contract. In addition, we may develop work product in connection with specific projects for our clients. Although our contracts with our clients generally provide that we retain the ownership rights to our work product, it is possible that clients may assert rights to, and seek to limit our ability to resell or reuse, our work product. Furthermore, in some cases we assign to clients the copyright and, at times, other intellectual property rights, in and to some aspects of the software, documentation, or other work product developed for these clients in connection with these projects, which limits our ability to resell or reuse this intellectual property.

Increasing government regulation could cause us to lose clients or impair our business.

We are subject not only to laws and regulations applicable to businesses generally, but we are also subject to certain U.S. and foreign laws and regulations applicable to our service offerings, including, but not limited to, those related to data privacy and security, electronic commerce, and call recording. Laws and regulations enacted in the United States, both at the state and federal level, as well as significant new rules issued with respect thereto, impose substantial requirements relating to the privacy and security of personal data, as well as the reporting of breaches with respect to personal data. Legislation that may be enacted in the future may add further requirements in these and other areas. In addition, we may be affected indirectly by legislation that impacts our existing and prospective clients, who may pass along to us by contract their legal obligations in these and other areas. Any such laws and regulations therefore could affect our existing business relationships or prevent us from obtaining new clients.

It may be difficult for us to access debt or equity markets to meet our financial needs.

In the event, for any reason, we need to raise additional funds in the future, through public or private debt or equity financings, such funds may not be available or may not be available on terms favorable to us. Additionally, the terms of the loan agreement we entered into with CIBC Bank USA f/k/a The PrivateBank and Trust Company (CIBC) on June 29, 2017 (the Loan Agreement) limits our ability to enter into a public or private debt financing. The failure by us to obtain such financing, if needed, may have a material adverse effect upon our business, financial condition, results of operations, and prospects.

The market price of our common stock is likely to be volatile and could subject us to litigation.

The trading price of our common stock has been, and is likely to continue to be, volatile and could be subject to wide fluctuations in response to various factors, some of which are beyond our control. In addition, the trading prices of the securities of technology companies in general have been highly volatile, and the volatility in market price and trading volume of securities is often unrelated or disproportionate to the financial performance of the companies issuing the securities. In addition to the factors discussed in this Risk Factors section and elsewhere in this Annual Report on Form 10-K, factors affecting the market price of our common stock include:

- actual or anticipated changes in our earnings or fluctuations in our operating results or in the expectations of securities analysts;
- price and volume fluctuations in the overall stock market from time to time;
- significant volatility in the market price and trading volume of comparable companies;
- changes in the market perception of behavioral and personality-based software products generally or in the effectiveness of our solutions in particular;
- announcements of technological innovations, new products, strategic alliances, or significant agreements by us or by our competitors;
- litigation involving us;
- investors' general perception of us;
- changes in general economic, industry, and market conditions and trends; and
- recruitment or departure of key personnel.

In addition, if the market for technology stocks or the stock market in general experiences uneven investor confidence, the market price of our common stock could decline for reasons unrelated to our business, operating results or financial condition. The market price of our common stock might also decline in reaction to events that affect other companies within, or outside, our industry even if these events do not directly affect us. Some companies that have experienced volatility in the trading price of their stock have been the subject of securities class action litigation. If we are the subject of such litigation, it could result in substantial costs and a diversion of our management's attention and resources from our business.

Because we do not anticipate paying any cash dividends on our common stock in the foreseeable future, capital appreciation, if any, will be your sole source of gains and you may never receive a return on your investment.

You should not rely on an investment in our common stock to provide dividend income. We have not declared or paid cash dividends on our common stock to date. In addition, the terms of our Loan Agreement with CIBC, and any future debt agreements may, preclude us from paying dividends. As a result, capital appreciation, if any, of our common stock will be your sole source of gain for the foreseeable future. Investors seeking cash dividends should not purchase our common stock.

Our operating results may be negatively affected if we are required to collect sales tax or other transaction taxes on all or a portion of sales in jurisdictions where we are currently not collecting and reporting tax.

Current economic and political conditions make sales and other transaction tax laws in many state, local, and foreign jurisdictions subject to reassessment and change. If a taxing authority were to successfully assert that we have not properly collected sales or other transaction taxes, or if sales or other transaction tax laws or the interpretation thereof were to change, and we were unable to enforce the terms of our contracts with customers that give us the right to reimbursement for assessed sales taxes, we could incur significant tax liabilities. Increased taxability of our products and services could increase our administrative costs, discourage clients from purchasing our products and services, or otherwise substantially harm our business and results of operations.

Item 1B. Unresolved Staff Comments.
Not applicable.

Item 2. Properties.
Our principal physical properties employed in our business consist of our leased office facilities in Chicago, Illinois; Edina, Minnesota; and Austin, Texas. Our executive offices are located at 200 West Madison Street, Suite 3100, Chicago, Illinois 60606. The initial lease term for this property, which became effective on June 1, 2015, terminates on July 31, 2022. This lease includes one five-year renewal option. The lease term for Edina, Minnesota, which became effective on June 1, 2011, was renewed until August 31, 2024. We ended the lease at one of our facilities in Austin, Texas on May 1, 2017 and entered into a lease at a new location in Austin, which became effective on April 1, 2016 and terminates on August 31, 2023.

Our total employable space is approximately 48,000 square feet. We do not own any real estate. We believe that our leased facilities are appropriate for our current business requirements.

Item 3. Legal Proceedings.
From time to time, we have been subject to legal claims arising in connection with our business and the results of these claims, when they arise, cannot be predicted with certainty. There are no asserted claims against us that, in the opinion of management, if adversely decided, would have a material effect on our business, financial position, results of operations, or prospects.

Item 4. Mine Safety Disclosures.
Not applicable.

PART II.

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities.

Our common stock, par value $0.01 per share (Common Stock), is traded on the NASDAQ Global Market under the symbol MATR. The following table sets forth, for the periods indicated, the high and low sales prices of our Common Stock on a quarterly basis, as reported on the NASDAQ Global Market.

	High	Low
2017		
Fourth Quarter	$2.90	$2.40
Third Quarter	3.00	2.10
Second Quarter	3.70	2.35
First Quarter	4.05	3.30
2016		
Fourth Quarter	$4.40	$3.00
Third Quarter	4.65	3.50
Second Quarter	4.38	3.23
First Quarter	6.70	3.85

There were approximately 105 holders of record of Common Stock as of March 2, 2018. The last reported sale price of Common Stock on the NASDAQ Global Market on March 2, 2018 was $2.30.

See Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters included in Part III Item 12 of this Annual Report on Form 10-K for more information about securities authorized for issuance under our various compensation plans.

Sale of Unregistered Securities

On February 23, 2017, we entered into a definitive purchase agreement for the sale of 5,328,187 shares of our common stock to certain investors and certain officers and directors in a private placement. Under the terms of the agreement, we raised approximately $16.0 million in gross proceeds by selling 5,228,187 shares to certain investors at a price of $3.00 per share and by selling 100,000 shares to certain officers and directors (including certain of their affiliates) at a price of $3.45 per share. The shares represented approximately 20% of the issued and outstanding shares of common stock immediately prior to the issuance. On March 1, 2017, we received aggregate gross proceeds, net of fees, of $14.8 million. Proceeds are being used for general corporate, working capital, and debt repayment purposes. Craig-Hallum Capital Group LLC, which acted as the sole placement agent for the offering, received a commission of $1.1 million, and was reimbursed for its out-of-pocket expenses. The company's registration statement on Form S-3 (File No. 333-217290) was filed with the SEC on April 13, 2017 and declared effective by the SEC on April 26, 2017.

The Shares were offered and will be sold to the purchasers under the purchase agreement in transactions exempt from registration under the Securities Act or state securities laws, in reliance on Section 4(a)(2) of the Securities Act and Rule 506 of Regulation D of the Securities Act and in reliance on similar exemptions under applicable state laws. Each of the purchasers represented that it is an accredited investor within the meaning of Rule 501(a) of Regulation D, and is acquiring its shares for investment only and not with a view towards, or for resale in connection with, the public sale or distribution thereof. The shares were offered without any general solicitation by us or our representatives.

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Stock Performance Graph

The following graph compares the cumulative total stockholder return on Common Stock with the cumulative total return of (i) a peer group of other publicly-traded information-technology consulting companies selected by us (the Peer Group Index), and (ii) the NASDAQ Global Market Index. Cumulative total stockholder return is based on the period from January 1, 2013 through December 31, 2017. The comparison assumes that $100 was invested on January 1, 2013 in each of Mattersight Common Stock, the Peer Group Index, and the NASDAQ Global Market Index, and that any and all dividends were reinvested.

Comparative Cumulative Total Return for Mattersight Corporation,

Peer Group Index, and NASDAQ Global Market Index

	12/31/12	12/31/13	12/31/14	12/31/15	12/31/16	12/31/17
Mattersight Common Stock	$ 100.00	$ 96.38	$ 125.75	$ 131.99	$ 74.45	$ 51.31
Peer Group Index(1)	100.00	132.06	172.27	155.74	166.24	213.91
NASDAQ Global Market Index	100.00	141.63	162.09	173.33	187.19	242.29

(1) The Peer Group Index consists of Verint Systems, Inc. and Nice Systems Limited.

Repurchase of Equity Securities

The following table provides information relating to our repurchase of shares of our Common Stock in the fourth quarter of 2017. These repurchases reflect shares withheld upon vesting of restricted stock to satisfy tax-withholding obligations.

Period	Total Number of Shares Purchased	Average Price Paid Per Share
October 1, 2017 – October 31, 2017	—	$ —
November 1, 2017 – November 30, 2017	41,895	$ 2.70
December 1, 2017 – December 31, 2017	1,572	$ 2.60
Total	43,467	$ 2.70

Dividends

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 our certificate of designations, our 7% Series B Convertible Preferred Stock (the Series B Stock) accrues dividends at a rate of 7% per year, payable semi-annually in January and July if declared by our board of directors. If not declared, unpaid dividends are cumulative and accrue at the rate of 7% per annum. Total accrued dividends for the periods July 1, 2012 through December 31, 2017 are $3.2 million, which will continue to be accrued until they are declared by the board of directors. Payment of future dividends on the Series B Stock will be determined by our board of directors based on our outlook and macroeconomic conditions.

The amount of each dividend accrual would decrease by any conversions of the Series B Stock into Common Stock, as Series B Stock conversions require us to pay accrued but unpaid dividends at the time of conversion. Conversions of Series B Stock became permissible at the option of the holder after June 19, 2002. For further discussion see Liquidity and Capital Resources included in Part II, Item 7 of this Annual Report on Form 10-K.

Equity Compensation Information

See Part III, Item 12 of this Annual Report on Form 10-K for information regarding shares of Common Stock that may be issued under our existing equity compensation plans.

Item 6. Selected Financial Data.

The following tables summarize our selected consolidated financial data. This information should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations, and the Consolidated Financial Statements of the Company and notes thereto, which are included elsewhere in this Annual Report on Form 10-K. The selected consolidated financial data in this section is not intended to replace the Consolidated Financial Statements of the Company and the notes thereto. Our historical results are not necessarily indicative of our future results.

	(In thousands, except per share data)(1)				
	December 31, 2017	December 31, 2016	December 31, 2015	December 31, 2014	December 31, 2013
Total revenue	$46,510	$ 42,097	$ 39,912	$ 30,319	$ 34,494
Loss from continuing operations	$(16,320)	$ (20,977)	$ (15,681)	$ (14,232)	$ (11,172)
Net loss available to common stockholders	$(16,904)	$ (21,563)	$ (16,269)	$ (14,821)	$ (11,761)
Basic loss from continuing operations per share	$(0.56)	$ (0.86)	$ (0.70)	$ (0.74)	$ (0.70)
Total assets	$39,935	$ 45,564	$ 40,402	$ 32,078	$ 30,749
Long-term debt	$17,056	$ 20,839	$ —	$ —	$ —
Series B Stock	$8,353	$ 8,354	$ 8,388	$ 8,406	$ 8,411
Capital leases	$3,157	$ 3,584	$ 3,433	$ 2,813	$ 2,832

(1) See Note One—Description of Business and Note Two—Summary of Significant Accounting Policies of the Notes to Consolidated Financial Statements included in Part II Item 8 of this Annual Report on Form 10-K for business discussion.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the Selected Financial Data and the consolidated financial statements and notes thereto included elsewhere in this Annual Report on Form 10-K.

Overview

We are a leader in behavioral analytics and a pioneer in personality-based software products. Using a stack of innovative, patented applications, Mattersight analyzes and predicts customer behavior based on the language exchanged between agents and customers during brand interactions. These insights are then used to facilitate more effective and effortless customer conversations, which, in turn, drive increased customer satisfaction and retention, employee engagement, and operating efficiency.

Business Metrics

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

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

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

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

Performance Highlights

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

	2017 (In millions, except percentage data)				
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Year
ACV bookings	3.5	2.5	5.2	2.8	14.0
Rolling four quarters ACV bookings	19.0	17.1	17.6	14.0	14.0
Backlog	14.5	13.1	14.6	8.9	8.9
Gross Margin	69 %	69 %	73 %	73 %	71 %

2016

(In millions, except percentage data)

Year

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	
ACV bookings	5.4	4.4	4.7	6.4	20.9
Rolling 4 quarters ACV bookings	25.1	23.7	21.5	20.9	20.9
Backlog	17.9	23.1	19.2	12.6	12.6
Gross Margin	68%	65%	67%	69%	67%

Critical Accounting Policies and Estimates

Our management’s discussion and analysis of financial condition and results of operations is based upon our 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 on an ongoing basis. Actual results may differ from these estimates under different assumptions or conditions.

The fiscal year-end dates referenced herein for 2017, 2016, and 2015, are December 31, 2017, December 31, 2016, and December 31, 2015, respectively.

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

Revenue Recognition

Subscription Revenue

Subscription revenue consists of revenue derived from Mattersight's Behavioral Analytics service offerings, including predictive behavioral routing, performance management, quality assurance, 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 we provide one or more of our 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 one to three years after the go-live date or, in cases where we contract 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 or pilot period. 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 our 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 our operational consulting services. The professional services are performed for our 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 with 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 our clients. An equivalent amount of reimbursable expenses is included in total cost of other revenue.

Unearned Revenue

Unearned revenue consists of billings or payments received in advance of revenue recognition for Behavioral Analytics contracts. Unearned revenue is recognized as revenue when the applicable 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, we 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 consolidated statements of operations in each reporting period. See Note Eighteen — Fair Value Measurements of the Notes to Consolidated Financial Statements included in Part II Item 8 of this Annual Report on Form 10-K.

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. We use historical information as the 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.

Goodwill

Goodwill is tested annually for impairment or more frequently if an event or circumstance indicates that an impairment loss may have been incurred. In performing our annual impairment test, we first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value, including goodwill. If it is concluded that this is the case for the reporting unit, we perform a detailed quantitative assessment. First the fair value of the reporting unit is compared with its carrying value. If the fair value exceeds the carrying value, then goodwill is not impaired and no further testing is performed. If the carrying value exceeds the fair value, then an impairment loss equal to the difference between the carrying and fair value will be recorded. We currently operate in a single business segment or reporting unit.

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. 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 continuing operating losses. 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 or achieving predictable levels of profitability.

We use 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.

We 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.

Other Significant Accounting Policies

For a description of our other significant accounting policies, see Note Two—Summary of Significant Accounting Policies of the Notes to Consolidated Financial Statements included in Part II Item 8 of this Annual Report on Form 10-K.

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 suggests that any call center interaction is four times more likely to drive customer disloyalty than increased loyalty. Given a rise in self-service, these interactions are only becoming more complex and fraught with greater risk.

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

- Drive new bookings growth and increase operating leverage;
- Leverage a "land and 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 and expand" model, focused on our routing product, will continue to accelerate the acquisition of new clients.

Results of Operations

	Year Ended December 31,			Year Ended December 31,		
(Dollars in millions)	2017	2016	Change	2016	2015	Change
Total revenue	$46.5	$42.1	10 %	$42.1	$39.9	6 %
Total cost of revenue, exclusive of depreciation and amortization	13.6	13.8	(2)%	13.8	10.7	29 %
Gross margin	33.0	28.3	16 %	28.3	29.2	(3)%
Other operating expenses	45.2	47.1	(4)%	47.1	44.3	6 %
Operating loss	12.2	18.8	(35)%	18.8	15.1	25 %
Non-operating expenses	4.2	2.1	98 %	2.1	0.6	260 %
Net loss	16.3	21.0	(22)%	21.0	15.7	34 %

Revenue

2017 Compared with 2016

Total revenue increased by $4.4 million, or 10%, when compared with 2016. The increase consisted of a $5.0 million increase in subscription revenue offset by a $0.6 million decrease in other revenue. Subscription revenue increased primarily due to $5.5 million from growth within existing client contracts and $1.0 million from new client contracts, partially offset by a decrease of $1.5 million from terminating contracts. Other revenue decreased primarily due to reduced recognition of deployment fees. Deployment fees are deferred and recognized over the contract's subscription period beginning on the go-live date. If a contract terminates early, remaining deferred deployment revenue is recognized upon termination.

Highest Revenue Generating Clients:

	(Percentage of Total Revenue)	
	2017	2016
Top 5 Clients	71 %	73 %
Top 10 Clients	86 %	87 %

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Clients Accounting for 10% or More of Total Revenue:

	(Percentage of Total Revenue)			
	2017		2016	
United HealthCare Services, Inc.	28	%	33	%
CVS Caremark Corporation	16	%	15	%
TriWest Healthcare Alliance Corp	14	%	9	%
Progressive Casualty Insurance Company	8	%	11	%

A substantial portion of our revenue comes from a limited number of clients. 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. United HealthCare Services, Inc., our largest customer in 2017, has expressed an intent to use less of our services in 2018, which could have a material impact on revenue.

2016 Compared with 2015

Total revenue increased by $2.2 million, or 6%, when compared with 2015. The increase consisted of a $2.6 million increase in subscription revenue offset by a $0.4 million decrease in other revenue. Subscription revenue increased primarily due to $6.0 million from new client contracts, partially offset by a decrease of $3.4 million from terminating contracts. Other revenue decreased primarily due to reduced recognition of deployment fees. Deployment fees are deferred and recognized over the contract's subscription period beginning on the go-live date. If a contract terminates early, remaining deferred deployment revenue is recognized upon termination.

Highest Revenue Generating Clients:

	(Percentage of Total Revenue)			
	2016		2015	
Top 5 Clients	73	%	73	%
Top 10 Clients	87	%	89	%

Clients Accounting for 10% or More of Total Revenue:

	(Percentage of Total Revenue)			
	2016		2015	
United HealthCare	33	%	31	%

Services, Inc.				
CVS Caremark Corporation	15	%	13	%
Progressive Casualty Insurance Company	11	%	15	%

Higher concentration of revenue with a single client or a limited group of clients creates increased revenue risk if one of these clients significantly reduces its demand for our services.

Total Cost of Revenue, Exclusive of Depreciation and Amortization

2017 Compared with 2016

Total costs of revenue consisted of $10.2 million of subscription revenue costs and $3.4 million of other revenue costs. Cost of subscription revenue was $10.2 million, or 23% of subscription revenue, in 2017, when compared with $10.4 million, or 27% of subscription revenue, in 2016. The $0.2 million decrease in cost was primarily due to a decrease in maintenance costs, partially offset by incremental personnel costs.

2016 Compared with 2015

Total costs of revenue consisted of $10.4 million of subscription revenue costs and $3.4 million of other revenue costs. Cost of subscription revenue was $10.4 million, or 27% of subscription revenue, in 2016, when compared with $8.1 million, or 22% of subscription revenue, in 2015. The $2.3 million increase in cost was primarily due to incremental personnel costs.

Other Operating Expenses

2017 Compared with 2016

Other operating expenses include product development, sales and marketing, general and administrative, and depreciation and amortization. Other operating expenses decreased in 2017 when compared with 2016 primarily as a result of a $3.5 million decrease in sales and marketing expenses, partially offset by a $0.8 million increase in product development expenses and a $0.4 million increase in depreciation and amortization.

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 decreased $3.5 million in 2017 when compared with 2016. The decrease was primarily due to one-time severance costs incurred in 2016, as well as decreased compensation costs related to a reduction in headcount.

Product development expenses increased $0.8 million in 2017 when compared with 2016 due to increased technology expenses, partially offset by decreased third-party product development costs.

Depreciation and amortization increased $0.4 million in 2017 when compared with 2016. The rise in expense resulted primarily from increased investments in technology, as well as the build out of our new Austin office in the first half of 2017.

2016 Compared with 2015

Other operating expenses include product development, sales and marketing, general and administrative, and depreciation and amortization. Other operating expenses increased in 2016 when compared with 2015 primarily as a result of a $3.1 million increase in sales and marketing expenses, and a $1.0 million increase in depreciation and amortization, partially offset by a $1.4 million decrease in product development expenses.

Sales and marketing expenses consist primarily of salaries, incentive compensation, commissions, and employee benefits for business development, account management, and marketing. Sales and marketing expenses increased $3.1 million in 2016 when compared with 2015. The increase was primarily due to one-time severance costs, as well as increased compensation costs related to the expansion of our sales and marketing teams.

Depreciation and amortization increased $1.0 million in 2016 when compared with 2015. The rise in expense resulted primarily from increased investments in technology, as well as the build out of our new Chicago office in late 2015.

Product development expenses decreased $1.4 million in 2016 when compared with 2015, primarily due to decreased compensation costs.

Non-Operating Expenses

2017 Compared with 2016

Non-operating expenses consist primarily of interest and other borrowing costs, loss on early extinguishment of debt, changes in the fair value of the warrant liability and other non-operating income. Non-operating expenses increased by $2.1 million in 2017 when compared with 2016.

Interest and other borrowing costs increased by $0.5 million in 2017 when compared with 2016. The increase is a result of interest on Hercules debt that was outstanding for the first half of 2017 and interest on the CIBC Bank USA f/k/a The PrivateBank and Trust Company (CIBC) line of credit draws outstanding for the remainder of the year.

The loss on the early extinguishment of Hercules debt totaled $1.8 million at June 29, 2017. It consisted of a prepayment charge of $0.7 million, acceleration of unaccreted debt discount of $0.6 million, and acceleration of unamortized deferred debt costs of $0.5 million.

Concurrent with issuance of the Hercules debt, the company issued a warrant that gives Hercules the right to purchase 357,142 shares of common stock at $3.50 per share. The warrant expires August 1, 2023. The warrant is accounted for as a liability and carried at fair market value using the Black-Scholes model. The change in fair value of the warrant liability increased $0.2 million in 2017 when compared with 2016 due to fluctuations in our stock price.

2016 Compared with 2015

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

Interest and other borrowing costs increased $1.7 million in 2016 when compared with 2015, primarily as a result of a new term loan with Hercules, which originated on August 1, 2016.

Income Tax Provision

Net deferred tax assets consist primarily of U.S. and non-U.S. net operating losses. Due to uncertainty in predicting when we will achieve the profitability required to utilize our operating losses, we have recognized a valuation allowance for the full amount of our net deferred tax assets.

2017 Compared with 2016

The income tax benefit was $0.1 million in 2017 and the income tax provision was $0.1 million in 2016. As of December 31, 2017 and 2016, total net deferred tax assets of approximately $58.1 million and $83.8 million, respectively, were fully offset by a valuation allowance.

2016 Compared with 2015

The income tax provision was $0.1 million and less than $0.1 million in 2016 and 2015, respectively. As of December 31, 2016 and 2015, total net deferred tax assets of approximately $83.8 million and $75.8 million, respectively, were fully offset by a valuation allowance.

Liquidity and Capital Resources

Sources and Uses of Cash

Our principal capital requirements are to fund working capital needs, capital expenditures for Behavioral Analytics and infrastructure requirements, and other revenue generation and growth investments. Our principal capital resources consisted of cash and cash equivalents of $9.0 million and $12.5 million at December 31, 2017 and December 31, 2016, respectively.

Net cash used in operating activities decreased by $8.0 million in 2017 when compared with 2016. The $4.7 million decrease in net loss, largely attributable to growth in customer base and a decrease in operating expenses in 2017, contributed to this decrease in net cash used in operating activities. Cash provided by collections on accounts receivable improved by $5.8 million and from unearned revenue increased by $0.5 million when compared with 2016. Cash used in investing activities decreased by $0.8 million in 2017 when compared with 2016 due to fewer fixed asset purchases. Net cash provided by financing activities decreased by $15.2 million in 2017 when compared with 2016, primarily as a result of $23.8 million of cash used to repay in full the principal balance and accrued and unpaid interest outstanding under the term loan with Hercules, partially offset by net $16.9 million of proceeds drawn on our credit line with CIBC (see Credit Facility below) and $14.8 million, net of fees received from the sale of 5,328,187 shares of common stock pursuant to a private placement of common stock.

Historically, we have not paid cash dividends on our common stock, and we do not expect to do so in the future. Our Series B stock accrues dividends at a rate of 7% per year, payable semi-annually in January and July if declared by our board of directors. If not declared, unpaid dividends are cumulative and accrue at the rate of 7% per year. Our board of directors has not declared a dividend payment on the Series B stock, which has been accrued, from July 1, 2012 through December 31, 2017 (the aggregate amount of these dividends was approximately $3.2 million). Payment of future dividends on the Series B stock will be determined by the board of directors based on our business outlook and macroeconomic conditions and may not exceed $0.2 million in the aggregate in any calendar year, as per our loan agreement with CIBC. The amount of each dividend accrual will be decreased by any conversions of the Series B stock into common stock, as such conversions require us to pay accrued but unpaid dividends at the time of conversion. Conversions of Series B stock are at the option of the holder.

Liquidity

As of December 31, 2017, our near-term capital resources consisted of our current cash balance, together with anticipated future cash flows, financing from capital leases, and borrowing capacity (see Credit Facility below). Our balance of cash and cash equivalents was $9.0 million as of December 31, 2017. Restricted cash of $2.7 million was used as collateral for letters of credit issued to support our equipment leasing activities.

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

Credit Facility

On June 29, 2017, we entered into the loan agreement with CIBC. The loan agreement provides for a revolving line of credit to us with a maximum credit limit of $20.0 million, which matures on June 29, 2020 (the credit facility). The credit facility is secured by a security interest in the company's assets. We, subject to certain limits and restrictions, may from time to time request the issuance of letters of credit under the loan agreement.

The principal amount outstanding under the credit facility will accrue interest at a floating annual rate equal to 1 month, 2 month or 3 month LIBOR (as selected by us) plus 4.50%, payable monthly. In addition, we will pay a non-use fee on the credit facility of 25 basis points (0.25%) per annum of the average unused portion of the credit facility. The amount we may borrow under the credit facility is limited to five times our monthly recurring revenue (as determined in accordance with the terms and conditions set forth in the loan agreement), multiplied by a dynamic churn factor that is based upon the ratio of recurring revenue retained in the prior twelve month period relative to the total amount of recurring revenue at the beginning of the period.

The loan agreement imposes various restrictions on us, including usual and customary limitations on our ability to incur debt and to grant liens upon our assets, increasing restrictions based on thresholds, prohibits certain consolidations, mergers, and sales and transfers of assets by us and requires us to comply with a trailing twelve months of total revenue and quarterly EBITDA (as adjusted in accordance with the loan agreement) targets. The loan agreement includes usual and customary events of default (with customary grace periods, as applicable) and provides that, upon the occurrence of an event of default, payment of all amounts payable under the loan agreement may be accelerated and/or the lender's commitments may be terminated. In addition, upon the occurrence of certain insolvency or bankruptcy related events of default, all amounts payable under the loan agreement will automatically become immediately due and payable, and the lender's commitments will automatically terminate.

Prior to entering into the loan agreement with CIBC, we were party to a loan agreement with Hercules. On June 29, 2017, we drew $13.5 million on the credit facility to repay the principal balance of $22.5 million, $0.7 million of prepayment charges, and $0.6 million of accrued and unpaid interest under our prior credit facility with Hercules. Upon effectiveness of the loan agreement and repayment of the Hercules credit facility, we terminated our loan agreement with Hercules.

See Note Eleven—Debt of the Notes to Consolidated Financial Statements included in Part II Item 8 of this Annual Report on Form 10-K.

Accounts Receivable Customer Concentration

As of December 31, 2017, three clients, United HealthCare Services, Inc., CVS Caremark Corporation and Progressive Casualty Insurance Company accounted for 29%, 13% and 13% of total gross accounts receivable, respectively. Of these amounts, we have collected 100% from United HealthCare Services, Inc., 100% from CVS Pharmacy, Inc., and 100% from Progressive Casualty Insurance Company through March 7, 2018. Of the total December 31, 2017 gross accounts receivable, we have collected 87% as of March 7, 2018. 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.

Capital Lease Obligations

We are a party to capital lease agreements with leasing companies to fund our ongoing equipment requirements. Capital lease obligations were $3.2 million as of December 31, 2017 and $3.6 million as of December 31, 2016. We expect to incur new capital lease obligations of approximately $1.9 million for 2018 as we continue to expand our investment in the infrastructure for Behavioral Analytics.

Contractual Obligations

Cash will be required for operating leases and non-cancellable purchase obligations, as well as various commitments reflected as liabilities on our balance sheet as of December 31, 2017. These commitments are as follows:

(In millions) Contractual Obligations	Total	Less Than 1 Year	1 – 3 Years	3 – 5 Years	More Than 5 Years
Revolving line of credit	$16.9	$ —	$16.9	$ —	$ —
Debt	0.3	0.1	0.2	—	—
Operating leases	4.2	0.9	2.0	0.8	0.5
Capital leases	3.5	2.2	1.3	—	—
Purchase obligations	4.9	3.6	1.3	—	—
Total	$29.8	$ 6.8	$21.7	$ 0.8	$ 0.5

Leases

The amounts set forth in the chart above reflect future principal, interest, and executory costs of the leases entered into by us 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 December 31, 2017 and December 31, 2016.

Purchase Obligations

Purchase obligations under long-term non-cancellable commitments are recorded at net present value in our balance sheet.

Letters of Credit

There were $3.4 million of standby letters of credit issued as collateral for capital and operating leases as of December 31, 2017. Certain letters of credit are secured by $2.7 million of restricted cash.

Off-Balance Sheet Arrangements

During 2017 and 2016, we did not have any relationships with unconsolidated financial partnerships, such as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk.

Historically, we have not experienced material fluctuations in our results of operations due to foreign currency exchange rate changes. We do not currently engage, nor is there any plan to engage, in hedging foreign currency risk.

We also have interest rate risk with respect to changes in variable interest rates on our revolving line of credit and other borrowings, capital leases, and cash and cash equivalents. Interest on the line of credit with CIBC is currently based on a 1 month, 2 month or 3 month LIBOR rate (as selected by the company) plus 4.50%. A change in interest rate impacts the interest and other borrowing costs and cash flows.

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Item 8. Financial Statements and Supplementary Data.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS OF MATTERSIGHT CORPORATION

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders

Mattersight Corporation

Opinion on the financial statements

We have audited the accompanying consolidated balance sheets of Mattersight Corporation (a Delaware corporation) and subsidiaries (the “Company”) as of December 31, 2017 and 2016, the related consolidated statements of operations, comprehensive loss, changes in shareholders’ equity, and cash flows for each of the three years in the period ended December 31, 2017, and the related notes and schedule (collectively referred to as the “financial statements”). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2017, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the Company’s internal control over financial reporting as of December 31, 2017, based on criteria established in the 2013 Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”), and our report dated March 12, 2018 expressed an unqualified opinion.

Basis for opinion

These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ GRANT THORNTON LLP

We have served as the Company’s auditor since 2006.

Chicago, Illinois
March 12, 2018

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders

Mattersight Corporation

Opinion on internal control over financial reporting

We have audited the internal control over financial reporting of Mattersight Corporation (a Delaware corporation) and subsidiaries (the "Company") as of December 31, 2017, based on criteria established in the 2013 Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on criteria established in the 2013 Internal Control—Integrated Framework issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the consolidated financial statements of the Company as of and for the year ended December 31, 2017, and our report dated March 12, 2018 expressed an unqualified opinion on those financial statements.

Basis for opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Annual Report of Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and limitations of internal control over financial reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ GRANT THORNTON LLP

Chicago, Illinois
March 12, 2018

MATTERSIGHT CORPORATION

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

	December 31, 2017	December 31, 2016
ASSETS:		
Current Assets:		
Cash and cash equivalents	$ 9,044	$ 12,538
Receivables net of allowances of $41 and $311, at December 31, 2017 and December 31, 2016, respectively	6,565	8,508
Prepaid expenses	5,805	4,440
Other current assets	65	296
Total current assets	21,479	25,782
Equipment and leasehold improvements, net of accumulated depreciation and amortization of $24,955 and $19,748, at December 31, 2017 and December 31, 2016, respectively	8,572	9,576
Goodwill	972	972
Intangibles assets, net of amortization of $4,357 and $3,820, respectively	2,952	3,201
Other long-term assets (includes $2,675 and $4,210 in restricted cash at December 31, 2017 and December 31, 2016, respectively)	5,960	6,033
Total assets	$ 39,935	$ 45,564
LIABILITIES AND STOCKHOLDERS' EQUITY:		
Current Liabilities:		
Short-term debt	$ 93	$ 738
Accounts payable	1,474	1,835
Accrued compensation and related costs	3,312	2,302
Unearned revenue	3,032	4,911
Capital leases	1,967	1,982
Other current liabilities	3,399	3,374
Total current liabilities	13,277	15,142
Long-term debt	17,056	20,839
Long-term unearned revenue	914	757
Long-term capital leases	1,190	1,602
Other long-term liabilities	6,475	5,945
Total liabilities	38,912	44,285
Series B convertible preferred stock, $0.01 par value; 5,000,000 shares authorized and designated; 1,637,786 and 1,637,948 shares issued and outstanding at December 31, 2017 and December 31, 2016, respectively,	8,353	

with a liquidation preference of $11,568 and $10,985 at December 31, 2017 and December 31, 2016, respectively