

EGAIN Corp  
Form 10-Q  
February 12, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended December 31, 2013

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 No. 001-35314

eGAIN CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	77-0466366
(State or other jurisdiction	(I.R.S. Employer
of incorporation or organization)	Identification No.)
1252 Borregas Avenue, Sunnyvale, CA	94089

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(Address of principal executive offices) (Zip Code)

(408) 636-4500

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer

Accelerated filer

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at February 6, 2014
Common Stock \$0.001 par value	25,403,053

eGAIN CORPORATION

Quarterly Report on Form 10-Q

For the Quarterly Period Ended December 31, 2013

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

## eGAIN CORPORATION

## CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except par value data)

	December 31, 2013 (Unaudited)	June 30, 2013
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 12,491	\$ 16,206
Restricted cash	29	29
Accounts receivable, less allowance for doubtful accounts of \$689 and \$392 at December 31, 2013 and June 30, 2013, respectively	9,372	12,307
Deferred commissions	1,410	1,745
Prepaid and other current assets	1,766	2,377
Total current assets	25,068	32,664
Property and equipment, net	4,323	3,544
Deferred commissions, net of current portion	435	776
Goodwill	4,880	4,880
Restricted cash, net of current portion	1,000	1,000
Other assets	712	672
Total assets	\$ 36,418	\$ 43,536
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 2,304	\$ 2,583
Accrued compensation	4,147	4,339
Accrued liabilities	1,433	2,478
Current portion of deferred revenue	18,045	15,679
Current portion of capital lease obligation	176	—
Current portion of bank borrowings	1,833	2,667
Related party notes payable	—	2,897
Total current liabilities	27,938	30,643
Deferred revenue, net of current portion	1,966	4,057
Capital lease obligation, net of current portion	187	—
Bank borrowings, net of current portion	1,500	2,000
Other long term liabilities	717	848
Total liabilities	32,308	37,548
Commitments and contingencies (Note 6)		
Stockholders' equity :		

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Common stock, \$0.001 par value – authorized: 50,000 shares; outstanding: 25,395 shares as of December 31, 2013 and 25,106 shares as of June 30, 2013	25	25
Additional paid-in capital	329,749	328,552
Notes receivable from stockholders	(89 )	(87 )
Accumulated other comprehensive loss	(1,020 )	(1,168 )
Accumulated deficit	(324,555 )	(321,334)
Total stockholders' equity	4,110	5,988
Total liabilities and stockholders' equity	\$ 36,418	\$43,536

See accompanying notes to condensed consolidated financial statements

## eGAIN CORPORATION

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

(in thousands, except per share data)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2013	2012	2013	2012
<b>Revenue:</b>				
Subscription and support	\$10,246	\$7,806	\$19,712	\$14,980
License	3,065	3,426	6,903	4,139
Professional services	4,354	3,505	6,732	6,341
<b>Total revenue</b>	<b>17,665</b>	<b>14,737</b>	<b>33,347</b>	<b>25,460</b>
Cost of subscription and support	1,951	1,208	3,922	2,604
Cost of license	26	46	52	91
Cost of professional services	3,859	3,012	7,395	5,915
<b>Total cost of revenue</b>	<b>5,836</b>	<b>4,266</b>	<b>11,369</b>	<b>8,610</b>
<b>Gross profit</b>	<b>11,829</b>	<b>10,471</b>	<b>21,978</b>	<b>16,850</b>
<b>Operating expenses:</b>				
Research and development	2,390	2,142	4,496	4,092
Sales and marketing	8,617	5,946	16,012	11,495
General and administrative	1,930	1,570	4,136	3,077
<b>Total operating expenses</b>	<b>12,937</b>	<b>9,658</b>	<b>24,644</b>	<b>18,664</b>
Income (loss) from operations	(1,108 )	813	(2,666 )	(1,814 )
Interest expense, net	(37 )	(136 )	(129 )	(277 )
Other expense, net	(18 )	93	(278 )	50
Income (loss) before income tax provision	(1,163 )	770	(3,073 )	(2,041 )
Income tax provision	(54 )	(129 )	(148 )	(202 )
<b>Net income (loss)</b>	<b>\$(1,217 )</b>	<b>\$641</b>	<b>\$(3,221 )</b>	<b>\$(2,243 )</b>
<b>Per share information:</b>				
Basic net income (loss) per common share	\$(0.05 )	\$0.03	\$(0.13 )	\$(0.09 )
Diluted net income (loss) per common share	\$(0.05 )	\$0.02	\$(0.13 )	\$(0.09 )
Weighted average shares used in computing basic net income (loss) per common share	25,356	24,670	25,267	24,593
Weighted average shares used in computing diluted net income (loss) per common share	25,356	26,099	25,267	24,593

See accompanying notes to condensed consolidated financial statements

eGAIN CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (Unaudited)

(in thousands)

	Three Months Ended		Six Months	
	December 31,		December 31,	
	2013	2012	2013	2012
Net income (loss)	\$ (1,217 )	\$ 641	\$ (3,221)	\$ (2,243)
Other comprehensive income (loss), net of taxes:				
Foreign currency translation adjustments	28	(103 )	148	(37 )
Comprehensive income (loss)	\$ (1,189 )	\$ 538	\$ (3,073)	\$ (2,280)



See accompanying notes to condensed consolidated financial statements



## eGAIN CORPORATION

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(in thousands)

	Six Months Ended December 31,	
	2013	2012
<b>Cash flows from operating activities:</b>		
Net loss	\$(3,221 )	\$(2,243 )
<b>Adjustments to reconcile net loss to net cash provided by operating activities:</b>		
Depreciation and amortization	984	571
Stock-based compensation	740	585
Provision for doubtful accounts	424	198
Amortization of deferred commission	1,010	643
Accrued interest on related party notes payable	19	222
<b>Changes in operating assets and liabilities:</b>		
Accounts receivable	3,023	(1,803 )
Deferred commissions	(299 )	(1,743 )
Prepaid expenses and other assets	654	(236 )
Accounts payable	(394 )	(883 )
Accrued compensation	(322 )	256
Accrued liabilities	(1,112 )	154
Deferred revenue	(179 )	14,185
Other long term liabilities	(150 )	27
Net cash provided by operating activities	1,177	9,933
<b>Cash flows from investing activities:</b>		
Purchases of property and equipment	(1,163 )	(623 )
Net cash used in investing activities	(1,163 )	(623 )
<b>Cash flows from financing activities:</b>		
Payments on bank borrowings	(1,334 )	(833 )
Payments on capital lease obligations	(119 )	—
Proceeds from bank borrowings	—	3,000
Payments on related party notes payable	(2,916 )	(3,000 )
Proceeds from exercise of stock options	457	261
Net cash used in financing activities	(3,912 )	(572 )
Effect of change in exchange rates on cash and cash equivalents	183	190
Net increase (decrease) in cash and cash equivalents	(3,715 )	8,928
Cash and cash equivalents at beginning of period	16,206	9,911
Cash and cash equivalents at end of period	\$12,491	\$18,839
<b>Supplemental cash flow disclosures:</b>		
Cash paid for interest	\$139	\$1,818
Cash paid for taxes	\$108	\$183
<b>Non-cash items:</b>		
Purchases of equipment through trade accounts payable	\$65	\$88
Property and equipment acquired under a capital lease	\$482	\$—

See accompanying notes to condensed consolidated financial statements

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eGAIN CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 1. Summary of Business and Significant Accounting Policies

Organization and Nature of Business

eGain Corporation (“eGain”, the “Company”, “our”, “we”, or “us”) is a leading provider of cloud-based and on-site customer engagement software solutions. For over a decade, our solutions have helped improve customer experience, grow sales, and optimize service processes across the web, social, and phone channels. Hundreds of global enterprises rely on us to transform fragmented sales engagement and customer service operations into unified customer engagement hubs. We have operations in the United States, United Kingdom, Netherlands, Ireland, Italy, Germany, France, South Africa, and India.

Principles of Consolidation

We have prepared the condensed consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission and included the accounts of our wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated. Certain information and footnote disclosures, normally included in financial statements prepared in accordance with generally accepted accounting principles, or GAAP, have been condensed or omitted pursuant to such rules and regulations although we believe that the disclosures made are adequate to make the information not misleading. In our opinion, the unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of our financial position, results of operations and cash flows for the periods presented.

These financial statements and notes should be read in conjunction with our audited consolidated financial statements and notes thereto for the fiscal year ended June 30, 2013, included in our Annual Report on Form 10-K. The condensed consolidated balance sheet at June 30, 2013 has been derived from audited financial statements as of that date but does not include all the information and footnotes required by GAAP for complete financial statements. The results of our operations for the interim periods presented are not necessarily indicative of results that may be expected for any other interim period or for the full fiscal year ending June 30, 2014. We have evaluated whether there were material subsequent events requiring recognition or disclosure, and there were none.

Segment Information

We operate in one segment, the development, license, implementation and support of our customer interaction software solutions. Operating segments are identified as components of an enterprise for which discrete financial information is available and regularly reviewed by the Company’s chief operating decision-makers in order to make decisions about resources to be allocated to the segment and assess its performance. Our chief operating decision-makers, under Accounting Standards Codification, or ASC, 280, Segment Reporting, are our executive management team. Our chief operating decision-makers review financial information presented on a consolidated basis for purposes of making operating decisions and assessing financial performance.

Information relating to our geographic areas for the three and six months ended December 31, 2013 and 2012 is as follows (unaudited, in thousands):

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	Three Months Ended		Six Months Ended	
	December 31,		December 31,	
	2013	2012	2013	2012
<b>Total Revenue:</b>				
North America	\$ 9,033	\$ 8,383	\$ 17,873	\$ 14,653
EMEA	7,870	6,292	14,656	10,670
Asia Pacific	762	62	818	137
	\$ 17,665	\$ 14,737	\$ 33,347	\$ 25,460
<b>Operating income (loss):</b>				
North America	\$ (494 )	\$ 865	\$ (1,038 )	\$ 116
EMEA	28	1,245	356	607
Asia Pacific*	(642 )	(1,297 )	(1,984 )	(2,536 )
	\$ (1,108 )	\$ 813	\$ (2,666 )	\$ (1,814 )

\* Includes costs associated with corporate support.

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In addition, identifiable tangible assets corresponding to our geographic areas are as follows (unaudited, in thousands):

	December 31, 2013	June 30, 2013
North America	\$ 16,642	\$ 25,939
EMEA	12,288	10,964
Asia Pacific	2,553	1,698
	\$ 31,483	\$ 38,601

The following table provides total revenue by category for the three and six months ended December 31, 2013 and 2012, respectively, (unaudited, in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2013	2012	2013	2012
Revenue :				
Cloud services	\$ 6,721	\$ 4,503	\$ 12,767	\$ 8,229
Maintenance and support services	3,525	3,303	6,945	6,751
License	3,065	3,426	6,903	4,139
Professional services	4,354	3,505	6,732	6,341
	\$ 17,665	\$ 14,737	\$ 33,347	\$ 25,460

For the three months ended December 31, 2013 and 2012, there was one customer that accounted for 16% and 19% of total revenue, respectively. For the six months ended December 31, 2013 and 2012, there was one customer that accounted for 18% and 17% of total revenue, respectively.

### Revenue Recognition

We enter into arrangements to deliver multiple products or services (multiple-elements). We apply software revenue recognition rules and multiple-elements arrangement revenue guidance. Significant management judgments and estimates are made and used to determine the revenue recognized in any accounting period. Material differences may result in changes to the amount and timing of our revenue for any period if different conditions were to prevail. We present revenue, net of taxes collected from customers and remitted to governmental authorities.

We derive revenue from three sources:

- (i) Subscription and support fees primarily consist of cloud revenue from customers accessing our enterprise cloud computing services, term license revenue, and maintenance and support revenue;
- (ii) License fees primarily consist of perpetual software license revenue;
- (iii) Professional services primarily consist of consulting, implementation services and training.

Revenue is recognized when all of the following criteria are met:

- Persuasive evidence of an arrangement exists: Evidence of an arrangement consists of a written contract signed by both the customer and management prior to the end of the period. We use signed software license, services agreements and order forms as evidence of an arrangement for sales of software, cloud, maintenance and support. We use signed statement of work as evidence of arrangement for professional services.

- Delivery or performance has occurred: Software is delivered to customers electronically or on a CD-ROM, and license files are delivered electronically. Delivery is considered to have occurred when we provide the customer access to the software along with login credentials.
- Fees are fixed or determinable: We assess whether the fee is fixed or determinable based on the payment terms associated with the transaction. Arrangements where a significant portion of the fee is due beyond 90 days from delivery are generally not considered to be fixed or determinable.

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·Collectibility is probable: We assess collectibility based on a number of factors, including the customer's past payment history and its current creditworthiness. Payment terms generally range from 30 to 90 days from invoice date. If we determine that collection of a fee is not reasonably assured, we defer the revenue and recognize it at the time collection becomes reasonably assured, which is generally upon receipt of cash payment.

We apply the provisions of ASC 985-605, Software Revenue Recognition, to all transactions involving the licensing of software products. In the event of a multiple element arrangement for a license transaction, we evaluate the transaction as if each element represents a separate unit of accounting taking into account all factors following the accounting standards. We apply ASC 605, Revenue Recognition, for cloud transactions to determine the accounting treatment for multiple elements. We also apply ASC 605-35 for fixed fee arrangements in which we use the percentage of completion method to recognize revenue when reliable estimates are available for the costs and efforts necessary to complete the implementation services. When such estimates are not available, the completed contract method is utilized. Under the completed contract method, revenue is recognized only when a contract is completed or substantially complete.

When licenses are sold together with system implementation and consulting services, license fees are recognized upon shipment, provided that (i) payment of the license fees is not dependent upon the performance of the consulting and implementation services, (ii) the services are available from other vendors, (iii) the services qualify for separate accounting as we have sufficient experience in providing such services, have the ability to estimate cost of providing such services, and we have vendor-specific objective evidence, or VSOE, of fair value, and (iv) the services are not essential to the functionality of the software.

We evaluate whether each of the elements in these arrangements represents a separate unit of accounting, as defined by ASC 605, using all applicable facts and circumstances, including whether (i) we sell or could readily sell the element unaccompanied by the other elements, (ii) the element has stand-alone value to the customer, and (iii) there is a general right of return. We use VSOE, of fair value for each of those units, when available. For revenue recognition with multiple-deliverable elements, in certain limited circumstances when VSOE of fair value does not exist, we apply the selling price hierarchy, which includes VSOE, third-party evidence of selling price, or TPE, and best estimate of selling price, or BEBP. We determine the relative selling price for a deliverable based on VSOE, if available, or BEBP, if VSOE is not available. We have determined that TPE is not a practical alternative due to differences in our service offerings compared to other parties and the availability of relevant third-party pricing information.

We determine BEBP by considering our overall pricing objectives and market conditions. Significant pricing practices taken into consideration include our discounting practices, the size and volume of our transactions, customer demographic, the geographic area where services are sold, price lists, its go-to-market strategy, historical standalone sales and contract prices. The determination of BEBP is made through consultation with and approval by our management, taking into consideration the go-to-market strategy. As our go-to-market strategies evolve, we may modify our pricing practices in the future, which could result in changes in relative selling prices, including both VSOE and BEBP.

## Subscription and Support Revenue

### Cloud Revenue

Cloud revenue consists of subscription fees from customers accessing our cloud-based service offerings. We recognize cloud services revenue ratably over the period of the applicable agreement as services are provided. Cloud agreements typically have an initial term of one or two years and automatically renew unless either party cancels the agreement. The majority of the cloud services customers purchase a combination of our cloud service and professional services. In some cases, the customer may also acquire a license for our software.

We consider the applicability of ASC 985-605, on a contract-by-contract basis. In cloud based agreements, where the customer does not have the contractual right to take possession of the software, the revenue is recognized on a monthly basis over the term of the contract. Invoiced amounts are recorded in accounts receivable and in deferred revenue or revenue, depending on whether the revenue recognition criteria have been met. We consider a software element to exist when we determine that the customer has the contractual right to take possession of our software at any time during the cloud period without significant penalty and can feasibly run the software on its own hardware or enter into another arrangement with a third party to host the software. Additionally, we have established VSOE for the cloud and maintenance and support elements of perpetual license sales, based on the prices charged when sold separately and substantive renewal terms. Accordingly, when a software element exists in a cloud services arrangement, license revenue for the perpetual software license element is determined using the residual method and is recognized upon delivery. Revenue for the cloud and maintenance and support elements is recognized ratably over the contractual time period. Professional services are recognized as described below under “Professional Services Revenue.” If VSOE of fair value cannot be established for the undelivered elements of an agreement, the entire amount of revenue from the arrangement is recognized ratably over the period that these elements are delivered.

#### Term License Revenue

Term license revenue includes arrangements where our customers receive license rights to use our software along with bundled maintenance and support services for the term of the contract. The majority of our contracts provide customers with the right to use one or more products up to a specific license capacity. Certain of our license agreements stipulate that customers can exceed pre-determined base capacity levels, in which case additional fees are specified in the license agreement. Term license revenue is recognized ratably over the term of the license contract.

#### Maintenance and Support Revenue

Maintenance and support revenue consists of customers purchasing maintenance and support for our on-premise software. We use VSOE of fair value for maintenance and support to account for the arrangement using the residual method, regardless of any separate prices stated within the contract for each element. Maintenance and support revenue is recognized ratably over the term of the maintenance contract, which is typically one year. Maintenance and support is renewable by the customer on an annual basis. Maintenance and support rates, including subsequent renewal rates, are typically established based upon a specified percentage of net license fees as set forth in the arrangement.

#### License Revenue

License revenue includes perpetual license rights sold to customers to use our software in conjunction with related maintenance and support services. If an acceptance period is required, revenue is recognized upon the earlier of customer acceptance or the expiration of the acceptance period. In software arrangements that include rights to multiple software products and/or services, we use the residual method under which revenue is allocated to the undelivered elements based on VSOE of the fair value of such undelivered elements. The residual amount of revenue is allocated to the delivered elements and recognized as revenue, assuming all other criteria for revenue recognition have been met. Such undelivered elements in these arrangements typically consist of software maintenance and support, implementation and consulting services and in some cases, cloud services.

We periodically sell to resellers. License sales to resellers as a percentage of total revenue were approximately 2% and 3% for the three months ended December 31, 2013 and 2012, respectively. License sales to resellers as a percentage of total revenue were approximately 9% and 2% for the six months ended December 31, 2013 and 2012, respectively. Revenue from sales to resellers is generally recognized upon delivery to the reseller but depends on the facts and circumstances of the transaction, such as our understanding of the reseller's plans to sell the software, if there are any return provisions, price protection or other allowances, the reseller's financial status and our experience with the particular reseller. Historically sales to resellers have not included any return provisions, price protections or other allowances.

#### Professional Services Revenue

Professional services revenue includes system implementation, consulting and training. For license transactions, the majority of our consulting and implementation services qualify for separate accounting. We use VSOE of fair value for the services to account for the arrangement using the residual method, regardless of any separate prices stated within the contract for each element. Our consulting and implementation service contracts are bid either on a fixed-fee basis or on a time-and-materials basis. Substantially all of our contracts are on a time-and-materials basis. For time-and-materials contracts, where the services are not essential to the functionality, we recognize revenue as services are performed. If the services are essential to functionality, then both the license revenue and the service revenue are recognized under the percentage of completion method. For a fixed-fee contract, we recognize revenue based upon the costs and efforts to complete the services in accordance with the percentage of completion method,

provided we are able to estimate such cost and efforts.

Under ASC 605-25, in order to account for deliverables in a multiple-deliverable arrangement as separate units of accounting, the deliverables must have standalone value upon delivery. For cloud services, in determining whether professional services have standalone value, we consider the following factors for each professional services agreement: availability of the services from other vendors, the nature of the professional services, the timing of when the professional services contract was signed in comparison to the subscription service start date and the contractual dependence of the subscription service on the customer's satisfaction with the professional services work.

As of June 30, 2013, we did not have standalone value for the professional services related to consulting and implementation of a majority of our core subscription services. This was due to the fact that we had historically performed the majority of these services to support our customers' implementation of the subscription services. We determined at or around July 1, 2013 that we had established standalone value for these implementation services. This was primarily due to the change in our business focus, the growing number of partners we trained and certified to perform these deployment services and the consequential sale of subscription services without bundled implementation service. Revenues earned from professional services related to consulting and implementation of a majority of our core subscription services are being accounted for separately from revenues earned from subscription services beginning July 1, 2013 when the standalone value was established for those professional services.

For those contracts that have standalone value, we recognized the services revenue when rendered for time and material contracts, when the milestones are achieved and accepted by the customer for fixed price contracts or by percentage of completion basis if there is no acceptance criteria.

For cloud, consulting and implementation services that do not qualify for separate accounting, we recognize the services revenue ratably over the estimated life of the customer cloud relationship, once cloud has gone live or system ready. We currently estimate the life of the customer cloud relationship to be approximately 28 months, based on the average life of all cloud customer relationships.

Training revenue that meets the criteria to be accounted for separately is recognized when training is provided.

#### Deferred Revenue

Deferred revenue primarily consists of payments received in advance of revenue recognition from cloud, term license, and maintenance and support services and is recognized as the revenue recognition criteria are met. We generally invoice customers in annual or quarterly installments. The deferred revenue balance does not represent the total contract value of annual or multi-year, non-cancelable cloud or maintenance and support agreements. Deferred revenue is influenced by several factors, including seasonality, the compounding effects of renewals, invoice duration, invoice timing and new business linearity within the quarter.

Deferred revenue that will be recognized during the succeeding twelve month period is recorded as current deferred revenue and the remaining portion is recorded as noncurrent.

#### Deferred Commissions

Deferred commissions are the direct and incremental costs directly associated with cloud contracts with customers and consist of sales commissions to the Company's direct sales force.

The commissions are deferred and amortized over the terms of the related customer contracts, which are typically one or two years. The commission payments are paid based on contract terms in the month following the quarter in which the commissions are earned. The deferred commission amounts are recognized under "Sales and marketing" expense in the condensed consolidated statements of operations over the terms of the related customer contracts, in proportion to the recognition of the associated revenue.

#### Accounts Receivable and Allowance for Doubtful Accounts

We extend unsecured credit to our customers on a regular basis. Our accounts receivable are derived from revenue earned from customers and are not interest bearing. We also maintain an allowance for doubtful accounts to reserve for potential uncollectible trade receivables. We review our trade receivables by aging category to identify specific

customers with known disputes or collectibility issues. We exercise judgment when determining the adequacy of these reserves as we evaluate historical bad debt trends, general economic conditions in the U.S. and internationally, and changes in customer financial conditions. If we made different judgments or utilized different estimates, material differences may result in additional reserves for trade receivables, which would be reflected by charges in general and administrative expenses for any period presented. We write off a receivable after all collection efforts have been exhausted and the amount is deemed uncollectible.

#### Receivable from Insurance Recovery

In certain circumstances, we record insurance recoveries that will be recognized during the succeeding twelve month period in other current assets. Such amounts represent pending insurance claims and are recorded net of any insurance deductible in accordance with the guidance in ASC 410, Asset Retirement and Environmental Obligations, and other interpretations for recognition of an asset related to insurance recovery when probable.

## Deferred Costs

Deferred costs are included in other assets. Such amounts include fees we pay to third party partners for technology and are deferred and amortized over the related customer contract term. Amortization of deferred third party partner fees is included in sales and marketing expense in the accompanying condensed consolidated statements of operations.

## Leases

Lease agreements are evaluated to determine whether they are capital or operating leases in accordance with ASC 840, Leases. When any one of the four test criteria in ASC 840 is met, the lease then qualifies as a capital lease.

Capital leases are capitalized at the lower of the net present value of the total amount payable under the leasing agreement (excluding finance charges) or the fair market value of the leased asset. Capital lease assets are depreciated on a straight-line basis, over a period consistent with our normal depreciation policy for tangible fixed assets, but not exceeding the lease term. Interest charges are expensed over the period of the lease in relation to the carrying value of the capital lease obligation.

Rent expense for operating leases, which may include free rent or fixed escalation amounts in addition to minimum lease payments, is recognized on a straight-line basis over the duration of each lease term.

## Stock-Based Compensation

We account for stock-based compensation in accordance with ASC 718, Compensation—Stock Compensation. Under the fair value recognition provisions of ASC 718, 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 the fair value of the stock-based awards at the grant date requires significant judgment and the use of estimates, particularly surrounding Black-Scholes valuation assumptions such as stock price volatility and expected option term.

Below is a summary of stock-based compensation included in the costs and expenses (unaudited, in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2013	2012	2013	2012
Cost of revenue	\$ 85	\$ 30	\$ 152	\$ 59
Research and development	52	78	99	155
Sales and marketing	160	90	293	186
General and administrative	97	83	196	185
Total stock-based compensation expense	\$ 394	\$ 281	\$ 740	\$ 585

We utilized the Black-Scholes valuation model for estimating the fair value of the stock-based compensation of options granted. All shares of our common stock issued pursuant to our stock option plans are only issued out of an authorized reserve of shares of common stock, which were previously registered with the Securities and Exchange Commission on a registration statement on Form S-8.

During the three months ended December 31, 2013 and 2012 there were 119,700 and 128,400 shares of common stock granted with a weighted-average fair value of \$7.44 and \$2.97, respectively. During the six months ended December 31, 2013 and 2012 there were 261,850 and 157,250 shares of common stock granted, respectively, with a weighted-average fair value of \$7.16 and \$2.99, respectively, using the following assumptions:

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	Three Months Ended December 31, 2013		2012		Six Months Ended December 31, 2013		2012	
Dividend yield	—		—		—		—	
Expected volatility	80	%	90	%	80	%	89	%
Average risk-free interest rate	1.44	%	0.69	%	1.47	%	0.69	%
Expected life (in years)	4.50		4.50		4.50		4.50	



The dividend yield of zero is based on the fact that we have never paid cash dividends and have no present intention to pay cash dividends. We determined the appropriate measure of expected volatility by reviewing historic volatility in the share price of our common stock, as adjusted for certain events that management deemed to be non-recurring and non-indicative of future events. The risk-free interest rate is derived from the average U.S. Treasury Strips rate with maturities approximating the expected lives of the awards during the period, which approximate the rate in effect at the time of the grant.

We base our estimate of expected life of a stock option on the historical exercise behavior, and cancellations of all past option grants made by the Company during the time period which its equity shares have been publicly traded, the contractual term of the option, the vesting period and the expected remaining term of the outstanding options.

Total compensation cost, net of forfeitures, of all options granted but not yet vested as of December 31, 2013 was \$2,200,826, which is expected to be recognized over the weighted average period of 1.43 years. There were 77,929 and 288,482 options exercised for the three and six months ended December 31, 2013 and 191,952 and 284,069 options exercised for three and six months ended December 31, 2012.

#### New Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board, or the FASB, issued ASU 2013-11, Income Taxes, which applies to all entities that have unrecognized tax benefits when a net operating loss, a similar tax loss, or a tax credit carryforward exists at the reporting date. The amendments in this update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013 (our fiscal 2015). We do not anticipate the adoption of this amendment to have a material impact on our consolidated financial statements.

In March 2013, the FASB issued ASU 2013-05, Foreign Currency Matters, which applies to the release of the cumulative translation adjustment into net income, when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary that is a nonprofit activity or business within a foreign entity. The amendments in this update are effective for public companies prospectively beginning after December 15, 2013 (our fiscal 2015), and interim and annual periods thereafter. We do not anticipate the adoption of this amendment to have a material impact on our consolidated financial statements.

#### Note 2. Net Income (Loss) per Common Share

Basic net income (loss) per common share is computed using the weighted-average number of shares of common stock outstanding. In periods where net income is reported, the weighted-average number of shares outstanding is increased by warrants and options in the money to calculate diluted net income per common share.

The following table represents the calculation of basic and diluted net income (loss) per common share (unaudited, in thousands, except per share data):

Three Months Ended December 31,	Six Months Ended December 31,
---------------------------------------	----------------------------------

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	2013	2012	2013	2012
Net income (loss) applicable to common stockholders	\$(1,217 )	\$641	\$(3,221 )	\$(2,243 )
Basic net income (loss) per common share	\$(0.05 )	\$0.03	\$(0.13 )	\$(0.09 )
Weighted-average common shares used in computing basic net income (loss) per common share	25,356	24,670	25,267	24,593
Effect of dilutive options and warrants	—	1,429	—	—
Weighted-average common shares used in computing diluted net income (loss) per common share	25,356	26,099	25,267	24,593
Diluted net income (loss) per common share	\$(0.05 )	\$0.02	\$(0.13 )	\$(0.09 )

Weighted average shares of stock options to purchase 2,136,411 and 2,210,706 shares of common stock for the three and six months ended December 31, 2013 and 726,836 and 2,650,351 shares of common stock for the three and six months ended December 31, 2012 were not included in the computation of diluted net income (loss) per common share due to their anti-dilutive effect. Such securities could have a dilutive effect in future periods.

## Note 3. Related Party Notes Payable

	Maturity	Interest Rate	December 31, 2013	June 30, 2013
Related party notes payable	7/31/2013	8 %	\$ —	\$ 2,897

We had an interest-bearing subordinated loan, or the Note, from our Chief Executive Officer, Ashutosh Roy, which originated in 2002 and previously had a maturity date of March 31, 2012. On March 31, 2012, we entered into Amendment No.1 to the loan agreement with Mr. Roy. Pursuant to Amendment No.1 and subject to the terms and conditions contained therein, we agreed that (i) the maturity date of the Note would be extended 90 days to June 29, 2012; (ii) as of April 1, 2012 the “Face Amount” of the Note would be \$5.6 million, which included \$109,000 of interest for the 90 day extension. The Face Amount of \$5.6 million reflects the reduced interest rate on the Note of 8% beginning April 1, 2012 prior to which the interest rate was 12%; and (iii) the Company may prepay the Note in full or in part at any time prior to the maturity date without interest penalty.

On June 29, 2012, we entered into Amendment No. 2 to the loan agreement with Mr. Roy. Pursuant to Amendment No. 2, and subject to the terms and conditions contained therein, we agreed to extend the maturity date of the Note to July 31, 2013. We could prepay the Note in full or in part at any time prior to the maturity date without interest penalty. On December 31, 2012, we made a \$3.0 million partial repayment to Mr. Roy bringing the remaining indebtedness to Mr. Roy to \$2.8 million.

On July 31, 2013, we repaid the outstanding amount of \$2.9 million owed to Mr. Roy and terminated the loan agreement. Interest expense on the related party notes was \$0 and \$111,000, respectively, for the three months ended December 31, 2013 and 2012. Interest expense on the related party notes was \$19,000 and \$222,000, respectively, for the six months ended December 31, 2013 and 2012.

## Note 4. Bank Borrowings

On June 27, 2011, we entered into a Loan and Security Agreement, or the Comerica Credit Facility, with Comerica Bank, or Comerica, as may be amended from time to time. Our obligations under the Comerica Credit Facility are collateralized by a lien on our assets. In addition, Mr. Roy has subordinated his security interests to those of Comerica pursuant to a Subordination Agreement dated as of June 27, 2011. The Comerica Credit Facility provides for the advance of up to the lesser of \$1.5 million under a revolving line of credit, or the sum of (i) 80% of certain qualified receivables, less (ii) the aggregate face amounts of any letters of credit issued and any outstanding obligations to Comerica. The revolving line of credit matured on June 27, 2012 and bore interest at a rate of prime plus 0.75% per annum. As of December 31, 2013 there was no outstanding balance under the revolving credit line. The Comerica Credit Facility also provided \$5.0 million to pay off obligations associated with our related parties, or the Comerica Term Loan, bears interest at a rate of prime plus 1.0% per annum, and is payable in 36 equal monthly payments of principal and interest with a maturity date of June 15, 2014. There are a number of affirmative and negative covenants under the Comerica Credit Facility, with the primary covenants being that we are required to maintain a minimum cash balance of \$1.0 million and we must maintain a liquidity to debt ratio of at least 1.50 to 1.00. If we fail to comply with our covenants, Comerica can declare any outstanding amounts immediately due and payable and stop extending credit to us. As of December 31, 2013, we were in compliance with the covenants. Additionally, we account for the \$1.0 million minimum cash balance as non-current restricted cash as the funds are not available for immediate withdraw or use and the term of the borrowing arrangement is more than 12 months. The Comerica Credit Facility also required Mr. Roy’s remaining related party debt to be repaid or converted to equity by the end of December 2011.

Pursuant to an Amendment to the Loan and Security Agreement entered into on December 28, 2011, the time period in which Mr. Roy's remaining related party debt to be repaid or converted to equity was extended to June 30, 2012. On June 28, 2012, we entered into another amendment that further extended the maturity date to July 31, 2013. In addition, Mr. Roy entered into an Affirmation of Subordination Agreement with Comerica, under which Mr. Roy acknowledges our execution of the Second Amendment and affirms his obligations under the Subordination Agreement with Comerica dated June 27, 2011.

On December 28, 2012, we entered into a Third Amendment to Loan and Security Agreement with Comerica, which amended the Second Loan and Security Agreement, entered into by the Company and the Bank on June 28, 2012. Subject to and upon the terms and conditions of the Loan Amendment, the Bank agreed to make a term loan to the Company in one disbursement in the amount of \$3.0 million, which the Company was obligated to use to pay down indebtedness owed to Mr. Roy. As of December 31, 2013 and June 30, 2013, the amount outstanding under the Comerica Term Loans was \$3.3 million and \$4.7 million, respectively.

The Third Amendment to Loan and Security Agreement provides, in addition to other terms and conditions contained therein, that (i) the maturity date of the term loan will be June 28, 2016; (ii) the Company shall repay the term loan in thirty-six (36) equal monthly installments of principal in the amount of \$83,333.33 each, plus all accrued interest, beginning on July 1, 2013, and continuing on the same day of each month thereafter through the maturity date, at which time remaining amounts due shall be immediately due and payable; (iii) the proceeds of the term loan must be used to pay-down the Note; (iv) the interest on the term loan is the prime interest rate plus one percent and (v) there are no prepayment penalties or warrants associated with the term loan.

On December 31, 2012, the Company used the proceeds of the term loan to pay \$3.0 million of the indebtedness due to Mr. Roy.

#### Note 5. Income Taxes

Income taxes are accounted for using the asset and liability method in accordance with ASC 740, Income Tax. Under this method, deferred tax liabilities and assets are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Based upon the weight of available evidence, which includes our historical operating performance and the reported cumulative net losses in all prior years, we have provided a full valuation allowance against our net deferred tax assets except the deferred tax assets related to India as we believe it is more likely than not that those assets will be realized. Our provision consists of foreign and state income taxes. Our income tax rate differs from the statutory tax rates primarily due to the utilization of net operating loss carry-forwards which had previously been valued against.

The Company accounts for uncertain tax positions according to the provisions of ASC 740. ASC 740 contains a two-step approach for recognizing and measuring uncertain tax positions. Tax positions are evaluated for recognition by determining if the weight of available evidence indicates that it is probable that the position will be sustained on audit, including resolution of related appeals or litigation. Tax benefits are then measured as the largest amount which is more than 50% likely of being realized upon ultimate settlement. The Company considers many factors when evaluating and estimating tax positions and tax benefits, which may require periodic adjustments and which may not accurately anticipate actual outcomes. No material changes have occurred in the Company's tax positions taken as of June 30, 2013 and in the three and six months ended December 31, 2013.

#### Note 6. Commitments and Contingencies

##### Warranty

We generally warrant that the program portion of our software will perform substantially in accordance with certain specifications for a period up to one year from the date of delivery. Our liability for a breach of this warranty is either a return of the license fee or providing a fix, patch, work-around or replacement of the software.

We also provide standard warranties against and indemnification for the potential infringement of third party intellectual property rights to our customers relating to the use of our products, as well as indemnification agreements with certain officers and employees under which we may be required to indemnify such persons for liabilities arising out of their duties to us. The terms of such obligations vary. Generally, the maximum obligation is the amount permitted by law.

Historically, costs related to these warranties have not been significant. Accordingly, we have no liabilities recorded for these costs as of December 31, 2013 and June 30, 2013. However, we cannot guarantee that a warranty reserve will not become necessary in the future.

#### Indemnification

We have also agreed to indemnify our directors and executive officers for costs associated with any fees, expenses, judgments, fines and settlement amounts incurred by any of these persons in any action or proceeding to which any of those persons is, or is threatened to be, made a party by reason of the person's service as a director or officer, including any action by us, arising out of that person's services as our director or officer or that person's services provided to any other company or enterprise at our request.

#### Transfer pricing

We have received transfer pricing assessments from tax authorities with regard to transfer pricing issues for certain fiscal years, which we have appealed with the appropriate authority. We believe that such assessments are without merit and would not have a significant impact on our consolidated financial statements.

## Litigation

On May 20, 2013, we filed suit against Pragmatum Telecom, LLC in the United States District of Delaware seeking a declaratory judgment that our products and services do not infringe directly or indirectly three patents purportedly owned by Pragmatum and that the claims of the Pragmatum patents are invalid. Pragmatum previously asserted these patents against certain of our customers. We have begun discovery and the matter is currently pending.

On May 17, 2013, we filed suit against Lodsyst Group, LLC in the United States District Court for the Eastern District of Texas seeking a declaratory judgment that our products and services do not infringe directly or indirectly two patents purportedly owned by Lodsyst and that the claims of the Lodsyst patents are invalid. Lodsyst previously asserted these patents against certain of our customers. The matter was settled on December 18, 2013. We entered into a settlement agreement which among other items provides a license to the Lodsyst patents. In the ordinary course of business, we are involved in various legal proceedings and claims related to alleged infringement of third-party patents and other intellectual property rights, commercial, corporate and securities, labor and employment, wage and hour, and other claims.

We make a provision for a liability relating to legal matters when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impact of negotiations, estimated settlements, legal rulings, advice of legal counsel and other information and events pertaining to a particular matter. In our opinion, resolution of all current matters is not expected to have a material adverse impact on our condensed consolidated results of operations, cash flows or financial position. However, depending on the nature and timing of any such dispute, an unfavorable resolution of a matter could materially affect our future results of operations or cash flows, or both, of a particular quarter.

## Note 7. Fair Value Measurement

ASC 820, Fair Value Measurement and Disclosures, defines fair value, establishes a framework for measuring fair value of assets and liabilities, and expands disclosures about fair value measurements. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the assets or liabilities in an orderly transaction between market participants on the measurement date. Subsequent changes in fair value of these financial assets and liabilities are recognized in earnings or other comprehensive income when they occur. ASC 820 applies whenever other statements require or permit assets or liabilities to be measured at fair value.

ASC 820 includes a fair value hierarchy, of which the first two are considered observable and the last unobservable, that is intended to increase the consistency and comparability in fair value measurements and related disclosures. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. Observable inputs reflect assumptions market participants would use in pricing an asset or liability based on market data obtained from independent sources while unobservable inputs reflect a reporting entity's pricing based upon their own market assumptions. The fair value hierarchy consists of the following three levels:

Level 1 – instrument valuations are obtained from real-time quotes for transactions in active exchange markets involving identical assets.

Level 2 – instrument valuations are obtained from readily-available pricing sources for comparable instruments.

Level 3 – instrument valuations are obtained without observable market value and require a high level of judgment to determine the fair value.

The following table summarizes the fair value hierarchy of our financial assets and liabilities measured (unaudited, in thousands):

	As of December		As of June 30, 2013	
	31, 2013		Level 1	Total Balance
	Level 1	Total Balance	Level 1	Total Balance
Assets				
Cash and Cash Equivalents:				
Money market funds	\$7,520	\$ 7,520	\$10,016	\$ 10,016
Total Assets	\$7,520	\$ 7,520	\$10,016	\$ 10,016

The Company uses quoted prices in active markets for identical assets or liabilities to determine fair value of Level 1 investments.



As of December 31, 2013 and June 30, 2013, we did not have any Level 2 or 3 assets or liabilities.

Our financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable and debt. We do not have any derivative financial instruments. We believe the reported carrying amounts of these financial instruments approximate fair value, based upon their short-term nature and comparable market information available at the respective balance sheet dates.

#### Note 8. Share Repurchase Program

On September 14, 2009, we announced that our board of directors approved a repurchase program under which we may purchase up to 1,000,000 shares of our common stock. The duration of the repurchase program is open-ended. Under the program, we purchase shares of common stock from time to time through the open market and privately negotiated transactions at prices deemed appropriate by management. The repurchase is funded by cash on hand. For the three and six months ended December 31, 2013 and 2012 there were no shares repurchased.

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

The following discussion in "Management's Discussion and Analysis of Financial Condition and Results of Operations" ("MD&A") contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). These statements may be identified by the use of the words such as "anticipates," "believes," "continue," "could," "would," "estimates," "expects," "intends," "may," "might," "plans," "potential," "should," or "will" and similar expressions or the negation of those terms. The forward-looking statements include, but are not limited to, statements regarding: the effect of changes in macroeconomic factors beyond our control; our hybrid revenue model and its potential impact on our total revenue; our ability to predict subscription renewals or upgrade rates; our lengthy sales cycles and the difficulty in predicting timing of sales or delays; competition in the markets in which we do business and our failure to compete successfully therein; our expectations regarding the composition of our customers and the result of a loss of a significant customer; the adequacy of our capital resources and need for additional financing and the effect of failing to obtain adequate funding; the development and expansion of our strategic and third party distribution partnership and relationships with systems integrators; our ability to effectively implement and improve our current products; our ability to innovate and respond to rapid technological change and competitive challenges; legal liability or the effect of negative publicity for the services provided to consumers via our technology platforms; legal and regulatory uncertainties and other risks related to protection of our intellectual property assets; our ability to anticipate our competitors; the operational integrity and maintenance of our systems; the effect of unauthorized access to a customer's data or our data or our IT systems; the uncertainty of demand for our products; the anticipated customer benefits from our products; the actual mix in new business between cloud and license transactions when compared with management's projections; our ability to develop and expand strategic and third party distribution channels; the ability to increase revenue as a result of the increased investment in sales and marketing; our ability to hire additional personnel and retain key personnel; the effect of any future changes to our sales organization on our revenue growth rate; our ability to expand and improve our sales performance and marketing activities; our ability to manage our expenditures and estimate future expenses, revenue, and operational requirements; the expenses associated with new data centers, additional data center capacity, real estate and office facilities space; our ability to manage our business plans, strategies and outlooks and any business-related forecasts or projections; the effect of the voluntary change in our accounting policy on our ability to compare our financial results with our industry peers; the effect of changes to management judgments and estimates; risks associated with the uncertainty of pending litigation; the result of our failure to comply with the covenants under the Comerica Loan; the impact of any modification to our pricing practices in the future; risks from our substantial international operations; our inability to successfully detect weaknesses or errors in our internal controls; our ability to manage future growth; the trading price of our common stock; geographical and currency fluctuations; and our expectations in fiscal 2014 with respect to revenue, cost of revenue, expenses and other financial metrics. Forward looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those expected. These risks and uncertainties include, but are not limited to, those risks discussed in "Risk Factors" Item 1A in this report and in our Annual Report on Form 10-K for the fiscal year ended June 30, 2013 which is incorporated herein by reference. Our actual results could differ materially from those discussed in statements relating to our future plans, product releases, objectives, expectations and intentions, and other assumptions underlying or relating to any of these statements. These forward-looking statements represent our estimates and assumptions and speak only as of the date hereof. We expressly disclaim any obligation or understanding to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based unless required by law.

All references to "eGain", the "Company", "our", "we" or "us" mean eGain Corporation and its subsidiaries, except where it is clear from the context that such terms mean only this parent company and excludes subsidiaries.

Overview

eGain Corporation is one of the premier providers of cloud and on-premise customer interaction software for sales and service. For over a decade, our solutions have helped improve customer experience, grow sales, and optimize service processes across the web, social, and phone channels. Hundreds of global enterprises rely on eGain to transform fragmented sales engagement and customer service operations into unified Customer Interaction Hubs. We have operations in the United States, United Kingdom, Netherlands, Ireland, Italy, Germany, South Africa and India.

#### Unbilled Deferred Revenue

Unbilled deferred revenue represents business that is contracted but not yet invoiced or collected and off-balance-sheet and, accordingly, is not recorded in deferred revenue. As such, the deferred revenue balance on our condensed consolidated balance sheets does not represent the total contract value of annual or multi-year, non-cancelable subscription agreements. As of December 31, 2013, unbilled deferred revenue decreased to \$17.7 million, from approximately \$24.8 million as of June 30, 2013.

## Critical Accounting Policies and Estimates

Management's Discussion and Analysis of Financial Condition and Results of Operations discuss our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires our management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the reporting period. On an on-going basis, our management evaluates its estimates and judgments, including those related to revenue recognition, allowance for doubtful accounts, deferred tax, valuation allowance and accrued liabilities, long-lived assets and stock-based compensation. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

There have been no material changes to these estimates for the periods presented in this Quarterly Report on Form 10-Q. For a detailed explanation of the judgments made in these areas, refer to "Management's Discussion and Analysis of Financial Condition and Results of Operations" within our Annual Report on Form 10-K for the year ended June 30, 2013, which we filed with the Securities and Exchange Commission on September 23, 2013.

We have reassessed the critical accounting policies as disclosed in our Annual Report on Form 10-K filed with the SEC on September 23, 2013 and determined that there were no significant changes to our critical accounting policies in the six months ended December 31, 2013.

## Revenue Recognition

We derive revenue from three sources:

- (i) Subscription and support fees primarily consist of cloud revenue from customers accessing our enterprise cloud computing services, term license revenue, and maintenance and support revenue;
- (ii) License fees primarily consist of perpetual software license revenue;
- (iii) Professional services primarily consist of consulting, implementation services and training.

We evaluate whether each of the elements in these arrangements represents a separate unit of accounting, as defined by ASC 605, using all applicable facts and circumstances, including whether (i) we sell or could readily sell the element unaccompanied by the other elements, (ii) the element has stand-alone value to the customer, and (iii) there is a general right of return. We use VSOE, of fair value for each of those units, when available. For revenue recognition with multiple-deliverable elements, in certain limited circumstances when VSOE of fair value does not exist, we apply the selling price hierarchy, which includes VSOE, third-party evidence of selling price, or TPE, and best estimate of selling price, or BEBP. We determine the relative selling price for a deliverable based on VSOE, if available, or BEBP, if VSOE is not available. We have determined that TPE is not a practical alternative due to differences in our service offerings compared to other parties and the availability of relevant third-party pricing information.

We determine BEBP by considering our overall pricing objectives and market conditions. Significant pricing practices taken into consideration include our discounting practices, the size and volume of our transactions, customer demographic, the geographic area where services are sold, price lists, its go-to-market strategy, historical standalone sales and contract prices. The determination of BEBP is made through consultation with and approval by our management, taking into consideration the go-to-market strategy. As our go-to-market strategies evolve, we may modify our pricing practices in the future, which could result in changes in relative selling prices, including both VSOE and BEBP.

## Subscription and Support Revenue

### Cloud Revenue

Cloud revenue consists of subscription fees from customers accessing our cloud-based service offerings. We recognize cloud services revenue ratably over the period of the applicable agreement as services are provided. Cloud agreements typically have an initial term of one or two years and automatically renew unless either party cancels the agreement. The majority of the cloud services customers purchase a combination of our cloud service and professional services. In some cases, the customer may also acquire a license for our software.

We consider the applicability of ASC 985-605, on a contract-by-contract basis. In cloud based agreements, where the customer does not have the contractual right to take possession of the software, the revenue is recognized on a monthly basis over the term of the contract. Invoiced amounts are recorded in accounts receivable and in deferred revenue or revenue, depending on whether the revenue recognition criteria have been met. We consider a software element to exist when we determine that the customer has the contractual right to take possession of our software at any time during the cloud period without significant penalty and can feasibly run the software on its own hardware or enter into another arrangement with a third party to host the software. Additionally, we have established VSOE for the cloud and maintenance and support elements of perpetual license sales, based on the prices charged when sold separately and substantive renewal terms. Accordingly, when a software element exists in a cloud services arrangement, license revenue for the perpetual software license element is determined using the residual method and is recognized upon delivery. Revenue for the cloud and maintenance and support elements is recognized ratably over the contractual time period. Professional services are recognized as described below under "Professional Services Revenue." If VSOE of fair value cannot be established for the undelivered elements of an agreement, the entire amount of revenue from the arrangement is recognized ratably over the period that these elements are delivered.

#### Term License Revenue

Term license revenue includes arrangements where our customers receive license rights to use our software along with bundled maintenance and support services for the term of the contract. The majority of our contracts provide customers with the right to use one or more products up to a specific license capacity. Certain of our license agreements stipulate that customers can exceed pre-determined base capacity levels, in which case additional fees are specified in the license agreement. Term license revenue is recognized ratably over the term of the license contract.

#### Maintenance and Support Revenue

Maintenance and support revenue consists of customers purchasing maintenance and support for our on-premise software. We use VSOE of fair value for maintenance and support to account for the arrangement using the residual method, regardless of any separate prices stated within the contract for each element. Maintenance and support revenue is recognized ratably over the term of the maintenance contract, which is typically one year. Maintenance and support is renewable by the customer on an annual basis. Maintenance and support rates, including subsequent renewal rates, are typically established based upon a specified percentage of net license fees as set forth in the arrangement.

#### License Revenue

License revenue includes perpetual license rights sold to customers to use our software in conjunction with related maintenance and support services. If an acceptance period is required, revenue is recognized upon the earlier of customer acceptance or the expiration of the acceptance period. In software arrangements that include rights to multiple software products and/or services, we use the residual method under which revenue is allocated to the undelivered elements based on VSOE of the fair value of such undelivered elements. The residual amount of revenue is allocated to the delivered elements and recognized as revenue, assuming all other criteria for revenue recognition have been met. Such undelivered elements in these arrangements typically consist of software maintenance and support, implementation and consulting services and in some cases, cloud services.

We periodically sell to resellers. License sales to resellers as a percentage of total revenue were approximately 2% and 3% for the three months ended December 31, 2013 and 2012, respectively. License sales to resellers as a percentage of total revenue were approximately 9% and 2% for the six months ended December 31, 2013 and 2012, respectively. Revenue from sales to resellers is generally recognized upon delivery to the reseller but depends on the facts and circumstances of the transaction, such as our understanding of the reseller's plans to sell the software, if there

are any return provisions, price protection or other allowances, the reseller's financial status and our experience with the particular reseller. Historically sales to resellers have not included any return provisions, price protections or other allowances.

## Professional Services Revenue

Professional services revenue includes system implementation, consulting and training. For license transactions, the majority of our consulting and implementation services qualify for separate accounting. We use VSOE of fair value for the services to account for the arrangement using the residual method, regardless of any separate prices stated within the contract for each element. Our consulting and implementation service contracts are bid either on a fixed-fee basis or on a time-and-materials basis. Substantially all of our contracts are on a time-and-materials basis. For time-and-materials contracts, where the services are not essential to the functionality, we recognize revenue as services are performed. If the services are essential to functionality, then both the license revenue and the service revenue are recognized under the percentage of completion method. For a fixed-fee contract, we recognize revenue based upon the costs and efforts to complete the services in accordance with the percentage of completion method, provided we are able to estimate such cost and efforts.

Under ASC 605-25, in order to account for deliverables in a multiple-deliverable arrangement as separate units of accounting, the deliverables must have standalone value upon delivery. For cloud services, in determining whether professional services have standalone value, we consider the following factors for each professional services agreement: availability of the services from other vendors, the nature of the professional services, the timing of when the professional services contract was signed in comparison to the subscription service start date and the contractual dependence of the subscription service on the customer's satisfaction with the professional services work.

As of June 30, 2013, we did not have standalone value for the professional services related to consulting and implementation of a majority of our core subscription services. This was due to the fact that we had historically performed the majority of these services to support our customers' implementation of the subscription services. We determined at or around July 1, 2013 that we had established standalone value for these implementation services. This was primarily due to the change in our business focus, the growing number of partners we trained and certified to perform these deployment services and the consequential sale of subscription services without bundled implementation service. Revenues earned from professional services related to consulting and implementation of a majority of our core subscription services are being accounted for separately from revenues earned from subscription services beginning July 1, 2013 when the standalone value was established for those professional services.

For those contracts that have standalone value, we recognized the services revenue when rendered for time and material contracts, when the milestones are achieved and accepted by the customer for fixed price contracts or by percentage of completion basis if there is no acceptance criteria.

For cloud, consulting and implementation services that do not qualify for separate accounting, we recognize the services revenue ratably over the estimated life of the customer cloud relationship, once cloud has gone live or system ready. We currently estimate the life of the customer cloud relationship to be approximately 28 months, based on the average life of all cloud customer relationships.

Training revenue that meets the criteria to be accounted for separately is recognized when training is provided.

## Deferred Revenue

Deferred revenue primarily consists of payments received in advance of revenue recognition from cloud, term license, and maintenance and support services and is recognized as the revenue recognition criteria are met. We generally invoice customers in annual or quarterly installments. The deferred revenue balance does not represent the total contract value of annual or multi-year, non-cancelable cloud or maintenance and support agreements. Deferred revenue is influenced by several factors, including seasonality, the compounding effects of renewals, invoice duration, invoice timing and new business linearity within the quarter.



Deferred revenue that will be recognized during the succeeding twelve month period is recorded as current deferred revenue and the remaining portion is recorded as noncurrent. At December 31, 2013, deferred revenue increased to \$20.0 million, compared to \$19.7 million at June 30, 2013.

#### Deferred Commissions

Deferred commissions are the direct and incremental costs directly associated with cloud contracts with customers and consist of sales commissions to the Company's direct sales force.

The commissions are deferred and amortized over the terms of the related customer contracts, which are typically one or two years. The commission payments are paid based on contract terms in the month following the quarter in which the commissions are earned. The deferred commission amounts are recognized as selling expense in the condensed consolidated statements of operations over the terms of the related customer contracts, in proportion to the recognition of the associated revenue.

## Results of Operations

The following table sets forth certain items reflected in our condensed consolidated statements of operations expressed as a percent of total revenue for the periods indicated:

	Three Months Ended December 31, 2013		2012		Six Months Ended December 31, 2013		2012	
<b>Revenue:</b>								
Subscription and support	58	%	53	%	59	%	59	%
License	17	%	23	%	21	%	16	%
Professional services	25	%	24	%	20	%	25	%
<b>Total revenue</b>	<b>100</b>	<b>%</b>	<b>100</b>	<b>%</b>	<b>100</b>	<b>%</b>	<b>100</b>	<b>%</b>
<b>Cost of revenue:</b>								
Cost of subscription and support	11	%	8	%	12	%	10	%
Cost of license	0	%	1	%	0	%	1	%
Cost of professional services	22	%	20	%	22	%	23	%
<b>Total cost of revenue</b>	<b>33</b>	<b>%</b>	<b>29</b>	<b>%</b>	<b>34</b>	<b>%</b>	<b>34</b>	<b>%</b>
<b>Gross margin</b>	<b>67</b>	<b>%</b>	<b>71</b>	<b>%</b>	<b>66</b>	<b>%</b>	<b>66</b>	<b>%</b>
<b>Operating expenses:</b>								
Research and development	14	%	15	%	14	%	16	%
Sales and marketing	48	%	40	%	48	%	45	%
General and administrative	11	%	10	%	12	%	12	%
<b>Total operating expenses</b>	<b>73</b>	<b>%</b>	<b>65</b>	<b>%</b>	<b>74</b>	<b>%</b>	<b>73</b>	<b>%</b>
<b>Income (loss) from operations</b>	<b>(6)</b>	<b>%</b>	<b>6</b>	<b>%</b>	<b>(8)</b>	<b>%</b>	<b>(7)</b>	<b>%</b>

## Revenue

(in thousands)	Three Months Ended December 31,				Six Months Ended December 31,			
	2013	2012	Change	%	2013	2012	Change	%
Subscription and support	\$10,246	\$7,806	\$2,440	31 %	\$19,712	\$14,980	\$4,732	32 %
License	3,065	3,426	(361)	(11)%	6,903	4,139	2,764	67 %
Professional services	4,354	3,505	849	24 %	6,732	6,341	391	6 %
<b>Total revenue</b>	<b>\$17,665</b>	<b>\$14,737</b>	<b>\$2,928</b>	<b>20 %</b>	<b>\$33,347</b>	<b>\$25,460</b>	<b>\$7,887</b>	<b>31 %</b>

Total revenue increased 20% to \$17.7 million in the quarter ended December 31, 2013 from \$14.7 million in the comparable year-ago quarter. Subscription and support revenue, which is comprised of cloud, term license and software maintenance and support revenue increased 31% to \$10.2 million in the quarter ended December 31, 2013 from \$7.8 million in the comparable year-ago quarter. The increase in subscription and support revenue was primarily due to the expansion within our current customer base and new cloud contracts. License revenue decreased 11% to \$3.1 million in the quarter ended December 31, 2013 from \$3.4 million in the comparable year-ago quarter. Professional services revenue increased 24% to \$4.4 million in the quarter ended December 31, 2013 from \$3.5 million in the comparable year-ago quarter. The increase in professional services revenue was primarily due to the professional services for cloud arrangements which we have determined to have value to the customer on a standalone basis as of July 1, 2013 and therefore are accounted for separately. When accounted for separately, these professional services revenues would generally be recognized as the services are rendered. Prior to this, professional services

revenue for cloud arrangements were recognized ratably over the longer of the remaining contractual period or the average estimated life of the customer cloud relationship, once the cloud has gone live or system ready.

Revenue in Europe and Asia Pacific increased 36% to \$8.6 million in the quarter ended December 31, 2013 from \$6.3 million in the comparable year-ago quarter. The increase in revenue outside of the Americas demonstrates increased acceptance of our product world-wide. The impact of the foreign exchange fluctuation between the U.S. Dollar and the Euro and British Pound resulted in a net increase of \$8,000 in total revenue for the six months ended December 31, 2013 as compared to the comparable year-ago period. To measure the impact of foreign exchange rate fluctuation, we recalculate current period results using the comparable prior period exchange rate.

## Cost of Revenue

(in thousands)	Three Months Ended December 31,				Six Months Ended December 31,			
	2013	2012	Change	%	2013	2012	Change	%
Subscription and support	\$1,951	\$1,208	\$743	62 %	\$3,922	\$2,604	\$1,318	51 %
License	26	46	(20 )	(43)%	52	91	(39 )	(43)%
Professional services	3,859	3,012	847	28 %	7,395	5,915	1,480	25 %
Total cost of revenue	\$5,836	\$4,266	\$1,570	37 %	\$11,369	\$8,610	\$2,759	32 %
Percentage of total revenue	33 %	29 %			34 %	34 %		
Gross margin	67 %	71 %			66 %	66 %		

Total cost of revenue increased 37% to \$5.8 million in the quarter ended December 31, 2013 from \$4.3 million in the comparable year-ago quarter. Total cost of revenue represented 33% and 29% of total revenue in the quarters ended December 31, 2013 and 2012, respectively. The change was primarily due to increases of (i) \$1.2 million in personnel and personnel-related expenses; (ii) \$285,000 in cloud related expenses such as hosted network and lease costs paid to remote co-location centers; (iii) \$173,000 in outside consulting partially offset by decreases of (i) \$49,000 from the foreign exchange fluctuation between the U.S. Dollar, the Euro, British Pound and India Rupee and (ii) \$21,000 in license related expenses. Gross margin for the quarter ended December 31, 2013 was 67% compared to 71% in the comparable year-ago quarter.

Total cost of revenue for the six months ended December 31, 2013 increased \$2.8 million, or 32%, compared to the same period last year. The change was primarily due to increases of (i) \$2.1 million in personnel and personnel-related expenses; (ii) \$624,000 in cloud related expenses such as hosted network and lease costs paid to remote co-location centers; (iii) \$184,000 in outside consulting partially offset by decreases of (i) \$107,000 from the foreign exchange fluctuation between the U.S. Dollar, the Euro, British Pound and India Rupee and (ii) \$39,000 in license related expenses. Gross margin for the six months ended December 31, 2013 and 2012 was 66%, respectively.

## Operating Expenses

## Research and Development

(in thousands)	Three Months Ended December 31,				Six Months Ended December 31,			
	2013	2012	Change	%	2013	2012	Change	%
Research and development	\$2,390	\$2,142	\$ 248	12 %	\$4,496	\$4,092	\$ 404	10 %
Percentage of total revenue	14 %	15 %			14 %	16 %		

Research and development expense primarily consists of compensation and benefits for our engineering, product management and development, and quality assurance personnel, fees for outside consultants and, to a lesser extent, occupancy costs and related overhead. Total costs for research and development for the three months ended December 31, 2013 increased 12% to \$2.4 million, compared to \$2.1 million for the comparable year-ago quarter. The change was primarily due to an increase of \$369,000 in personnel and personnel-related expenses partially offset by decreases of (i) \$44,000 in outside consulting services and (ii) \$77,000 from the foreign exchange fluctuation between the U.S. Dollar, the Euro, British Pound and India Rupee. Total research and development revenue as a percentage of total revenue was 14% and 15% for the quarters ended December 31, 2013 and 2012, respectively.

Research and development costs for the six months ended December 31, 2013 increased \$404,000, or 10%, compared to the same period last year. The change was primarily due to an increase of \$667,000 in personnel and personnel-related expenses partially offset by decreases of (i) \$116,000 in outside consulting services and (ii) \$148,000 from the foreign exchange fluctuation between the U.S. Dollar, the Euro, British Pound and India Rupee. Total research and development revenue as a percentage of total revenue was 14% and 16% for the six months ended December 31, 2013 and 2012, respectively.

## Sales and Marketing

(in thousands)	Three Months Ended December 31,				Six Months Ended December 31,			
	2013	2012	Change	%	2013	2012	Change	%
Sales and marketing	\$8,617	\$5,946	\$2,671	45%	\$16,012	\$11,495	\$4,517	39%
Percentage of total revenue	48	% 40	%		48	% 45	%	

Sales and marketing expense primarily consist of compensation and benefits for our sales, marketing and business development personnel, lead generation activities, advertising, trade show and other promotional costs and, to a lesser extent, occupancy costs and related overhead. Sales and marketing expense increased 45% to \$8.6 million in the quarter ended December 31, 2013 from \$5.9 million in the comparable year-ago quarter. The change was primarily due to increases of (i) \$2.3 million in personnel and personnel-related expenses of which \$52,000 relates to sales commissions; (ii) \$296,000 in marketing programs and public relations; (iii) \$165,000 from outside consulting services; (iv) \$34,000 from the foreign exchange fluctuation between the U.S. Dollar, the Euro, British Pound and India Rupee partially offset by a decrease of \$108,000 in third party partner fees. Total sales and marketing expense as a percentage of total revenue was 48% and 40% for the quarters ended December 31, 2013 and 2012, respectively.

Sales and marketing expense for the six months ended December 31, 2013 increased \$4.5 million, or 39%, compared to the same period last year. The change was primarily due to increases of (i) \$3.8 million in personnel and personnel-related expenses of which \$720,000 relates to sales commissions; (ii) \$471,000 in marketing programs and public relations; (iii) \$391,000 from the foreign exchange fluctuation between the U.S. Dollar, the Euro, British Pound and India Rupee; and (iv) \$179,000 from outside consulting services partially offset by a decrease of \$324,000 in third party partner fees. Total sales and marketing expense as a percentage of total revenue was 48% and 45% for the six months ended December 31, 2013 and 2012, respectively.

## General and Administrative

(in thousands)	Three Months Ended December 31,				Six Months Ended December 31,			
	2013	2012	Change	%	2013	2012	Change	%
General and administrative	\$1,930	\$1,570	\$360	23%	\$4,136	\$3,077	\$1,059	34%
Percentage of total revenue	11	% 10	%		12	% 12	%	

General and administrative expense primarily consist of compensation and benefits for our finance, human resources, administrative and legal personnel, fees for outside professional services, provision for doubtful accounts and, to a lesser extent, occupancy costs and related overhead. Total general and administrative expense increased 23% to \$1.9 million in the quarter ended December 31, 2013 from \$1.6 million in the comparable year-ago quarter. The change was primarily due to increases of (i) \$232,000 in personnel and personnel-related expense; (ii) \$201,000 in legal expenses partially offset by decreases of (i) \$58,000 in accounting, investor relations and other outside consulting related expenses and (ii) \$21,000 from outside consulting services. Total general and administrative expense as a percentage of total revenue was 11% and 10% for the quarters ended December 31, 2013 and 2012, respectively.

General and administrative expense for the six months ended December 31, 2013 increased \$1.1 million, or 34%, compared to the same period last year. The change was primarily due to increases of (i) \$574,000 in legal expenses; (ii) \$421,000 in personnel and personnel-related expense; and (iii) \$111,000 in bad debt expense partially offset by a decrease of \$48,000 in accounting, investor relations and other outside consulting related expenses. Total general and

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administrative expense as a percentage of total revenue was 12% for both six month periods ended December 31, 2013 and 2012, respectively.

Income (loss) from Operations

(in thousands)	Three Months Ended December 31,				Six Months Ended December 31,			
	2013	2012	Change	%	2013	2012	Change	%
Income (loss) from operations	\$(1,108)	\$813	\$(1,921)	(236)%	\$(2,666)	\$(1,814)	\$(852)	47%
Operating margin	(6)	6			(8)	(7)		

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Loss from operations in the quarter ended December 31, 2013 was \$1.1 million which included \$394,000 of stock-based compensation expenses compared to income from operations of \$813,000 which included \$281,000 of stock-based compensation expenses in the comparable year-ago quarter. We recorded a 6% negative operating margin in the quarter ended December 31, 2013, compared to a 6% operating margin in the comparable year-ago quarter.

Loss from operations for the six months ended December 31, 2013 was \$2.7 million which included \$740,000 of stock-based compensation expense. During the same period last year, loss from operations was \$1.8 million which included \$585,000 of stock-based compensation expense.

#### Interest Expense, Net

Interest expense consists of interest on our related party notes payable and bank borrowings. Interest expense, net was \$37,000 and \$129,000 in the three and six months ended December 31, 2013 compared to \$136,000 and \$277,000 in the three and six months ended December 31, 2012. The decrease in interest expense primarily relates to the repayment of related party debt in July 2013.

#### Other Expense, Net

Other expense primary consists of exchange rate gain/loss on foreign currency transactions. Other expense was \$18,000 and \$278,000 for the three and six months ended December 31, 2013 compared to other income of \$93,000 and \$50,000 for the three and six months ended December 31, 2012.

#### Income Tax Provision

The income tax expenses primarily relate to foreign and state income tax expense. We recorded an income tax provision of \$54,000 and \$148,000 for the three and six months ended December 31, 2013 compared to \$129,000 and \$202,000 for the three and six months ended December 31, 2012.

#### Liquidity and Capital Resources

##### Overview

As of December 31, 2013 our cash and cash equivalents and restricted cash were \$13.5 million and our negative working capital was \$2.9 million compared to cash and cash equivalents and restricted cash of \$17.2 million and working capital of \$2.0 million as of June 30, 2013. As of December 31, 2013, our deferred revenue was \$20.0 million compared to \$19.7 million on June 30, 2013.

Based upon our fiscal year 2014 plan, we believe that existing capital resources will enable us to maintain current and planned operations for at least the next 12 months. From time to time, however, we may consider opportunities for raising additional capital and/or exchanging all or a portion of our existing debt for equity. We can make no assurances that such opportunities will be available to us on economic terms we consider favorable, if at all.

If adequate funds are not available on acceptable terms, our ability to achieve or sustain positive cash flows, maintain current operations, fund any potential expansion, take advantage of unanticipated opportunities, develop or enhance products or services, or otherwise respond to competitive pressures would be significantly limited. Our expectations as to our future cash flows and our future cash balances are subject to a number of assumptions, including assumptions regarding anticipated increases in our revenue, the mix of new cloud and license business, our ability to retain existing customers and customer purchasing and payment patterns, many of which are beyond our control.



Related Party Notes Payable

On July 31, 2013, we repaid the outstanding amount of \$2.9 million owed under the interest-bearing subordinated loan, or the Note, from our Chief Executive Officer and terminated the loan agreement.

Accounting for Unauthorized Wire Transfers

On February 15, 2013, our U.K. subsidiary discovered that three unauthorized wire transfers, or the Unauthorized Transactions, in the amount of approximately \$3.9 million were made from our bank account on February 14, 2013. We promptly obtained a court order freezing the funds, contacted law enforcement and obtained an independent third-party investigation firm to investigate the matter.

With the assistance of the independent third-party investigation firm and our bank, approximately \$2.7 million was recovered and re-deposited to our bank account in March 2013. We filed an insurance claim for approximately \$1.2 million of the remaining outstanding funds and reported the pending insurance recovery net of a \$25,000 deductible as a receivable from our insurance carrier under "Prepaid and other current assets" on our consolidated balance sheet as of June 30, 2013.

On September 6, 2013, we received insurance proceeds of \$1.2 million for the pending claim we filed with our insurance carrier.

#### Cash Flows

Net cash provided by operating activities was \$1.2 million for the six months ended December 31, 2013 compared to \$9.9 million in the comparable year-ago period. The decrease was primarily due a net loss of \$3.2 million for the six months ended December 31, 2013 compared to a net loss of \$2.2 million in the comparable year-ago period after adjusting for depreciation, amortization of deferred commissions, stock-based compensation, and changes in working capital accounts specifically, decreases in deferred revenue and accounts receivable.

Net cash used in investing activities was \$1.2 million during the six months ended December 31, 2013 and \$623,000 during the comparable year-ago period. The net cash used in investing activities during the six months ended December 31, 2013 and 2012 primarily related to purchase of computer equipment for new employees and computer hardware to support the growth in our cloud business.

Net cash used in financing activities was \$3.9 million during the six months ended December 31, 2013 and \$572,000 during the comparable year-ago period. Net cash used in financing activities for the six months ended December 31, 2013 included the repayment of \$2.9 million on related party notes, repayment of \$1.3 million of existing bank borrowings and \$119,000 principal payment on a capital lease obligation partially offset by net proceeds of \$457,000 on the exercise of stock options. Net cash used in financing activities for the six months ended December 31, 2012 included the repayment of \$3.0 million on related party notes, repayment of \$833,000 of existing bank borrowings partially offset by net proceeds of \$3.0 million from new bank borrowings and \$261,000 on the exercise of stock options.

#### Commitments

There was no significant change to our contractual obligations since June 30, 2013.

#### Off-Balance Sheet Arrangements

As of December 31, 2013, we had no off-balance-sheet arrangements, as defined in Item 303(a)(4) of SEC Regulation S-K, other than operating leases and co-location agreement that were included in our commitment schedule as disclosed in our Annual Report on Form 10-K for the fiscal year ended June 30, 2013. There was no significant change since June 30, 2013.

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

We develop products in the United States and India and sell these products internationally. Generally, sales are made in local currency. As a result, our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. Identifiable assets denominated in foreign currency at

December 31, 2013 totaled approximately \$14.8 million. We do not currently use derivative instruments to hedge against foreign exchange risk. As such we are exposed to market risk from fluctuations in foreign currency exchange rates, principally from the exchange rate between the U.S Dollar and the Euro, British Pound and the India Rupee. During the six months ended December 31, 2013, there was no significant fluctuation in foreign currency exchange rates between the U.S. Dollar and the Euro and the British Pound and the India Rupee. If the U.S. Dollar strengthens in future periods, we may experience an adverse effect on our financial position or results of operations.

Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures. We maintain “disclosure controls and procedures,” as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, the Exchange Act, that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Our disclosure controls and procedures have been designed to meet reasonable assurance standards. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, our Chief Executive Officer and Chief Financial Officer have concluded that, as of December 31, 2013, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in internal controls. There was no change in our internal control over financial reporting (as defined in Rule 13a-15(d) under the Exchange Act) that occurred during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

On May 20, 2013, we filed suit against Pragmatum Telecom, LLC in the United States District of Delaware seeking a declaratory judgment that our products and services do not infringe directly or indirectly three patents purportedly owned by Pragmatum and that the claims of the Pragmatum patents are invalid. Pragmatum previously asserted these patents against certain of our customers. We have begun discovery and the matter is currently pending.

On May 17, 2013, we filed suit against Lodsyst Group, LLC in the United States District Court for the Eastern District of Texas seeking a declaratory judgment that our products and services do not infringe directly or indirectly two patents purportedly owned by Lodsyst and that the claims of the Lodsyst patents are invalid. Lodsyst previously asserted these patents against certain of our customers. The matter was settled on December 18, 2013. We entered into a settlement agreement which among other items provides a license to the Lodsyst patents.

In the ordinary course of business, we are involved in various legal proceedings and claims related to alleged infringement of third-party patents and other intellectual property rights, commercial, corporate and securities, labor and employment, wage and hour, and other claims.

We make a provision for a liability relating to legal matters when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impact of negotiations, estimated settlements, legal rulings, advice of legal counsel and other information and events pertaining to a particular matter. In our opinion, resolution of all current matters is not expected to have a material adverse impact on our consolidated results of operations, cash flows or financial position. However, depending on the nature and timing of any such dispute, an unfavorable resolution of a matter could materially affect our future results of operations or cash flows, or both, of a particular quarter.

### Item 1A. Risk Factors

The risks and uncertainties described below are not the only ones facing us. Other events that we do not currently anticipate or that we currently deem immaterial also may affect our results of operations, cash flows and financial condition.

Our business is influenced by a range of factors that are beyond our control and that we have no comparative advantage in forecasting. These include:

- general economic and business conditions;
- currency exchange rate fluctuations;
- the overall demand for enterprise software and services;
- customer acceptance of cloud-based solutions;
- governmental budgetary constraints or shifts in government spending priorities; and
- general political developments.

The continued global economic crisis caused a general tightening in the credit markets, lower levels of liquidity, increases in the rates of default and bankruptcy, and extreme volatility in credit, equity and fixed income markets. These macroeconomic developments negatively affected, and could continue to negatively affect, our business,

operating results or financial condition which, in turn, could adversely affect our stock price. A general weakening of, and related declining corporate confidence in, the global economy or the curtailment in government or corporate spending could cause current or potential customers to reduce their technology budgets or be unable to fund software or services purchases, which could cause customers to delay, decrease or cancel purchases of our products and services or cause customers not to pay us or to delay paying us for previously purchased products and services.

Because we recognize revenue from subscriptions for our service over the term of the subscription, downturns or upturns in new business may not be immediately reflected in our operating results.

We generally recognize revenue from customers ratably over the terms of their subscription agreements, which are typically 12 to 36 months. As a result, most of the revenue we report in each quarter is the result of subscription agreements entered into during previous quarters. Consequently, a decline in new or renewed subscriptions in any one quarter may not be reflected in our revenue results for that quarter. Any such decline, however, will negatively affect our revenue in future quarters. Accordingly, the effect of significant downturns in sales and market acceptance of our service, and potential changes in our rate of renewals may not be fully reflected in our results of operations until future periods. Our subscription model also makes it difficult for us to rapidly increase our revenue through additional sales in any period, as revenue from new customers must be recognized over the applicable subscription term.

We cannot accurately predict subscription renewal or upgrade rates and the impact these rates may have on our future revenue and operating results.

Our customers have no obligation to renew their subscriptions for our service after the expiration of their initial subscription period, which is typically 12 to 36 months, and in fact, some customers have elected not to renew. In addition, our customers may renew for fewer subscriptions, renew for shorter contract lengths, or renew for lower cost editions of our service. We cannot accurately predict renewal rates given our varied customer base of enterprise and small and medium size business customers and the number of multiyear subscription contracts. Our renewal rates may decline or fluctuate as a result of a number of factors, including customer dissatisfaction with our service, customers' spending levels, decreases in the number of users at our customers, pricing changes and deteriorating general economic conditions. If our customers do not renew their subscriptions for our service or reduce the number of paying subscriptions at the time of renewal, our revenue will decline and our business will suffer.

Our future success also depends in part on our ability to sell additional features and services, more subscriptions or enhanced editions of our service to our current customers. This may also require increasingly sophisticated and costly sales efforts that are targeted at senior management. Similarly, the rate at which our customers purchase new or enhanced services depends on a number of factors, including general economic conditions and that our customers do not react negatively to any price changes related to these additional features and services. If our efforts to upsell to our customers are not successful and negative reaction occurs, our business may suffer.

Our hybrid revenue model may affect our operating results.

We have a hybrid delivery model meaning that we offer our solutions on a cloud or license basis to our customers. For license transactions, the license revenue amount is generally recognized in the quarter delivery and acceptance of our software takes place. Whereas, for cloud transactions, cloud revenue is recognized ratably over the term of the cloud contract, which is typically one to two years. As a result, our total revenue may increase or decrease in future quarters as a result of the timing and mix of license and cloud transactions. This could be exacerbated as more customers employ our cloud solution over our licensed solution; causing us to increase the amount of revenue recognized ratably over the life of the contract therefore resulting in a decrease in our total revenue in the short-term.

Our lengthy sales cycles and the difficulty in predicting timing of sales or delays may impair our operating results.

The long sales cycle for our products may cause license revenue and operating results to vary significantly from period to period. The sales cycle for our products can be six months or more and varies substantially from customer to customer. Because we sell complex and deeply integrated solutions, it can take many months of customer education to secure sales. Because our potential customers may evaluate our products before, if ever, executing definitive agreements, we may incur substantial expenses and spend significant management effort in connection with the

potential customer. Our multi-product offering and the increasingly complex needs of our customers contribute to a longer and unpredictable sales cycle. Consequently, we often face difficulty predicting the quarter in which expected sales will actually occur. This contributes to the uncertainty and fluctuations in our future operating results. In particular, the corporate decision-making and approval process of our customers and potential customers has become more complicated. This has caused our average sales cycle to further increase and, in some cases, has prevented the closure of sales that we believed were likely to close. In addition, historically our license sales have comprised a relatively small number of high value transactions; consequently, we may miss our revenue forecasts and may incur expenses that are not offset by corresponding revenue from the delay in even one transaction.



Because we depend on a relatively small number of customers for a substantial portion of our revenue, the loss of any of these customers or our failure to attract new significant customers could adversely impact our revenue and harm our business.

We have in the past and expect in the future to derive a substantial portion of our revenue from sales to a relatively small number of customers. The composition of these customers has varied in the past, and we expect that it will continue to vary over time. As a result, the loss of any significant customer or a decline in business with any significant customer would materially and adversely affect our financial condition and results of operations.

We must compete successfully in our market segment.

The market for customer engagement software is intensely competitive. Other than product innovation and existing customer relationships, there are no substantial barriers to entry in this market, and established or new entities may enter this market in the future. While software internally developed by enterprises represents indirect competition, we also compete directly with packaged application software vendors, including Avaya, Inc., Genesys Telecommunications, LivePerson, Inc., and Moxie Software, Inc. In addition, we face actual or potential competition from larger software companies such as Microsoft Corporation, Oracle Corporation, Salesforce.com, Inc. and similar companies that may attempt to sell customer engagement software to their installed base.

We believe competition will continue to be fierce as current competitors increase the sophistication of their offerings and as new participants enter the market. Many of our current and potential competitors have longer operating histories, larger customer bases, broader brand recognition, and significantly greater financial, marketing and other resources. With more established and better-financed competitors, these companies may be able to undertake more extensive marketing campaigns, adopt more aggressive pricing policies, and make more attractive offers to businesses to induce them to use their products or services.

We have experienced growth in recent periods and expect to continue to grow. If we fail to manage our growth effectively, we may be unable to execute our business plan, maintain high levels of service or adequately address competitive challenges.

To achieve our business objectives, we will need to continue to expand our business. This expansion has placed, and is expected to continue to place, a significant strain on our managerial, administrative, operational, financial and other resources. We anticipate that expansion will require substantial management effort and additional investment in our infrastructure and headcount. If we are unable to successfully manage our growth, our business, financial condition and results of operations will be adversely affected.

Part of the challenge that we expect to face in the course of our expansion is the need to increase staffing, primarily to develop new sales strategies and to expand into different markets. We have considerable need to recruit, train, and retain qualified staff and any delays or difficulties we encounter in these staffing efforts could impair our ability to execute our business plan.

We intend to continue to expand our distribution channels into international markets and to spend significant financial and managerial resources to do so. If we are successful in our expansion or are unable to provide adequate service to this expansion, our business and operating results will suffer.

If we fail to expand and improve our sales performance and marketing activities, we may be unable to grow our business, negatively impacting our operating results and financial condition.

Expansion and growth of our business is dependent on our ability to expand our sales force and on the ability of our sales force to increase sales. If we are not able to effectively develop and maintain awareness of our products in a cost-effective manner, we may not achieve widespread acceptance of our existing and future products. This may result in a failure to expand and attract new customers and enhance relationships with existing customers. This may impede our efforts to improve operations in other areas of the Company and may result in declines in the market price of our common stock.

Due to the complexity of our customer engagement hub platform and related products and services, we must utilize highly trained sales personnel to educate prospective customers regarding the use and benefits of our products and services as well as provide effective customer support. If we have turnover in our sales and marketing teams, we may not be able to successfully compete with those of our competitors.

Our failure to develop and expand strategic and third party distribution channels would impede our revenue growth.

Our success and future growth depends in part upon the skills, experience, performance and continued service of our distribution partners, including software and hardware vendors and resellers. We engage with distribution partners in a number of ways, including assisting us to identify prospective customers, to distribute our products in geographies where we do not have a physical presence and to distribute our products where they are considered complementary to other third party products distributed by the partner. We believe that our future success depends in part upon our ability to develop and expand strategic, long term and profitable partnerships and reseller relationships. If we are unable to do so, or if any existing or future distribution partners fail to successfully market, resell, implement or support our products for their customers, or if distribution partners represent multiple providers and devote greater resources to market, resell, implement and support competing products and services, our future revenue growth could be impeded. Our failure to develop and expand relationships with systems integrators could harm our business.

We sometimes rely on system integrators to recommend our products to their customers and to install and support our products for their customers. We likewise depend on broad market acceptance by these system integrators of our product and service offerings. Our agreements generally do not prohibit competitive offerings and system integrators may develop market or recommend software applications that compete with our products. Moreover, if these firms fail to implement our products successfully for their customers, we may not have the resources to implement our products on the schedule required by their customers. To the extent we devote resources to these relationships and the partnerships do not proceed as anticipated or provide revenue or other results as anticipated, our business may be harmed. Once partnerships are forged, there can be no guarantee that such relationships will be renewed in the future or available on acceptable terms. If we lose strategic third party relationships, fail to renew or develop new relationships, or fail to fully exploit revenue opportunities within such relationships, our results of operations and future growth may suffer.

Our international operations involve various risks.

We derived 49% and 43% of our revenue from international sales for the quarter ended December 31, 2013 and 2012, respectively. Including those discussed above, our international sales operations are subject to a number of specific risks, such as:

- general economic conditions in each country or region in which we do or plan to do business;
- foreign currency fluctuations and imposition of exchange controls;
- expenses associated with complying with differing technology standards and language translation issues;
- difficulty and costs in staffing and managing our international operations;
- difficulties in collecting accounts receivable and longer collection periods;
- health or similar issues, such as a pandemic or epidemic;
- various trade restrictions and tax consequences;
- hostilities in various parts of the world; and
- reduced intellectual property protections in some countries.

As of December 31, 2013, approximately 49% of our workforce was employed in India. Of these employees, 34% are allocated to research and development. Although the movement of certain operations internationally was principally motivated by cost cutting, the continued management of these remote operations requires significant management attention and financial resources that could adversely affect our operating performance. In addition, with the significant increase in the numbers of foreign businesses that have established operations in India, the competition to attract and retain employees there has increased significantly. As a result of the increased competition for skilled workers, we experienced increased compensation costs and expect these costs to increase in the future. Our reliance on our workforce in India makes us particularly susceptible to disruptions in the business environment in that region. In particular, sophisticated telecommunications links, high-speed data communications with other eGain offices and

customers, and overall consistency and stability of our business infrastructure are vital to our day-to-day operations, and any impairment of such infrastructure will cause our financial condition and results to suffer. The maintenance of stable political relations between the United States, European Union and India are also of great importance to our operations.

Any of these risks could have a significant impact on our product development, customer support, or professional services. To the extent the benefit of maintaining these operations abroad does not exceed the expense of establishing and maintaining such activities, our operating results and financial condition will suffer.

Our revenue and operating expenses are unpredictable and may fluctuate, which may harm our operating results and financial condition.

Due to the emerging nature of the multichannel contact center market and other similar factors, our revenue and operating results may fluctuate from quarter to quarter. Our revenue could fall short of expectations if we experience delays or cancellations of even a small number of orders. It is possible that our operating results in some quarters will be below the expectations of financial analysts or investors. In this event, the market price of our common stock is also likely to decline.

A number of factors are likely to cause fluctuations in our operating results, including, but not limited to, the following:

- demand for our software and budget and spending decisions by information technology departments of our customers;
- the mix of cloud and license transactions;
- seasonal trends in technology purchases;
- our ability to attract and retain customers;
- product offerings and pricing of our competitors; and
- litigation relating to our intellectual proprietary rights.

In addition, we base our expense levels in part on expectations regarding future revenue levels. In the short term, expenses, such as employee compensation and rent, are relatively fixed. If revenue for a particular quarter is below expectations, we may be unable to reduce our operating expenses proportionately for that quarter. Accordingly, such a revenue shortfall would have a disproportionate effect on expected operating results for that quarter. For this reason, period-to-period comparisons of our operating results may also not be a good indication of our future performance.

We may need additional capital, and raising such additional capital may be difficult or impossible and will likely significantly dilute existing stockholders.

We believe that existing capital resources will enable us to maintain current and planned operations for the next 12 months. However, our working capital requirements in the foreseeable future are subject to numerous risks and will depend on a variety of factors, in particular, whether we maintain or exceed the level of revenue achieved as of December 31, 2013 and that customers continue to pay on a timely basis. We may need to secure additional financing due to unforeseen or unanticipated market conditions. We may try to raise additional funds through public or private financings, strategic relationships, or other arrangements. Such financing may be difficult to obtain on terms acceptable to us, if at all. If we succeed in raising additional funds through the issuance of equity or convertible securities, then the issuance could result in substantial dilution to existing stockholders. If we raise additional funds through the issuance of debt securities or preferred stock, these new securities would have rights, preferences, and privileges senior to those of the holders of our common stock. The terms of these securities could impose restrictions on our operations.

Difficulties in implementing our products could harm our revenue and margins.

We generally recognize license revenue from a customer sale when persuasive evidence of an arrangement exists, the product has been delivered, the arrangement does not involve significant customization of the software, the license fee is fixed or determinable and collection of the fee is probable. If an arrangement requires significant customization or implementation services from us, recognition of the associated license and service revenue could be delayed. The timing of the commencement and completion of these services is subject to factors that may be beyond our control, as this process requires access to the customer's facilities and coordination with the customer's personnel after delivery of the software. In addition, customers could cancel or delay product implementations. Implementation typically

involves working with sophisticated software, computing and communications systems. If we experience difficulties with implementation or do not meet project milestones in a timely manner, we could be obligated to devote more customer support, engineering and other resources to a particular project. Some customers may also require us to develop customized features or capabilities. If new or existing customers cancel or have difficulty deploying our products or require significant amounts of our professional services, support, or customized features, revenue recognition could be cancelled or further delayed and our costs could increase, causing increased variability in our operating results.

Our reserves may be insufficient to cover receivables we are unable to collect.

We assume a certain level of credit risk with our customers in order to do business. Conditions affecting any of our customers could cause them to become unable or unwilling to pay us in a timely manner, or at all, for products or services we have already provided them. In the past, we have experienced collection delays from certain customers, and we cannot predict whether we will continue to experience similar or more severe delays in the future. Although we have established reserves to cover losses due to delays or inability to pay, there can be no assurance that such reserves will be sufficient to cover our losses. If losses due to delays or inability to pay are greater than our reserves, it could harm our business, operating results and financial condition.

We may be subject to legal liability and/or negative publicity for the services provided to consumers via our technology platforms.

Our technology platforms enable representatives of our customers as well as individual service providers to communicate with consumers and other persons seeking information or advice on the Internet. The law relating to the liability of online platform providers such as us for the activities of users of their online platforms is often challenged in the U.S. and internationally. We may be unable to prevent users of our technology platforms from providing negligent, unlawful or inappropriate advice, information or content via our technology platforms, or from behaving in an unlawful manner, and we may be subject to allegations of civil or criminal liability for negligent, fraudulent, unlawful or inappropriate activities carried out by users of our technology platforms.

Claims could be made against online services companies under both U.S. and foreign law such as fraud, defamation, libel, invasion of privacy, negligence, copyright or trademark infringement, or other theories based on the nature and content of the materials disseminated by users of our technology platforms. In addition, domestic and foreign legislation has been proposed that could prohibit or impose liability for the transmission over the Internet of certain types of information. Our defense of any of these actions could be costly and involve significant time and attention of our management and other resources.

The Digital Millennium Copyright Act, or DMCA, is intended, among other things, to reduce the liability of online service providers for listing or linking to third party web properties that include materials that infringe copyrights or rights of others. Additionally, portions of The Communications Decency Act, or CDA, are intended to provide statutory protections to online service providers who distribute third party content. A safe harbor for copyright infringement is also available under the DMCA to certain online service providers that provide specific services, if the providers take certain affirmative steps as set forth in the DMCA. Important questions regarding the safe harbor under the DMCA and the CDA have yet to be litigated, and we cannot guarantee that we will meet the safe harbor requirements of the DMCA or of the CDA. If we are not covered by a safe harbor, for any reason, we could be exposed to claims, which could be costly and time-consuming to defend.

Unplanned system interruptions and capacity constraints and failure to effect efficient transmission of customer communications and data over the Internet could harm our business and reputation.

Our customers have in the past experienced some interruptions with eGain-hosted operations. We believe that these interruptions will continue to occur from time to time. These interruptions could be due to hardware and operating system failures. As a result, our business will suffer if we experience frequent or long system interruptions that result in the unavailability or reduced performance of our cloud operations or reduce our ability to provide remote management services. We expect to experience occasional temporary capacity constraints due to sharply increased traffic or other Internet-wide disruptions, which may cause unanticipated system disruptions, slower response times, impaired quality, and degradation in levels of customer service. If this were to continue to happen, our business and reputation could be seriously harmed.

The growth in the use of the Internet has caused interruptions and delays in accessing the Internet and transmitting data over the Internet. Interruptions also occur due to systems burdens brought on by unsolicited bulk email or “Spam,” malicious service attacks and hacking into operating systems, viruses, worms and a “Trojan” horse, the proliferation of which is beyond our control and may seriously impact our and our customers’ businesses.

Because we provide Cloud-based software, interruptions or delays in Internet transmissions will harm our customers’ ability to receive and respond to online interactions. Therefore, our market depends on ongoing improvements being made to the entire Internet infrastructure to alleviate overloading and congestion.

Our success largely depends on the efficient and uninterrupted operation of our computer and communications hardware and network systems. A significant amount of our computer and communications systems are located in Sunnyvale, California. Due to our location, our systems and operations are vulnerable to damage or interruption from fire, earthquake, power loss, telecommunications failure and similar events.



We do maintain a business continuity plan for our customers in the event of an outage. We maintain other co-locations for the purposes of disaster recovery as well as maintaining back up's of our customer's information.

We have entered into service agreements with some of our customers that require minimum performance standards, including standards regarding the availability and response time of our remote management services. If we fail to meet these standards, our customers could terminate their relationships with us, and we could be subject to contractual refunds and service credits to customers. Any unplanned interruption of services may harm our ability to attract and retain customers.

The terms we agree to in our Service Level Agreements or other contracts may result in increased costs or liabilities, which would in turn affect our results of operations.

Our Service Level Agreement (SLA) includes indemnification provisions and provides for service credits for system unavailability, and loss, damage or costs resulting from use of our system. If we were required to provide any of these in a material way, our results of operations would suffer.

We have been and may in the future be sued by third parties for various claims including alleged infringement of proprietary rights.

We are involved in various legal matters arising from the normal course of business activities. These may include claims, suits, and other proceedings involving alleged infringement of third-party patents and other intellectual property rights, and commercial, labor and employment, and other matters.

The software and Internet industries are characterized by the existence of a large number of patents, trademarks and copyrights and by frequent litigation based on allegations of infringement or other violations of intellectual property rights. We have received in the past and may receive in the future communications from third parties claiming that we or our customers have infringed the intellectual property rights of others. In addition we have been, and may in the future be, sued by third parties for alleged infringement of their claimed proprietary rights. Our technologies and those of our customers may be subject to injunction if they are found to infringe the rights of a third party or we may be required to pay damages, or both. Many of our agreements require us to indemnify our customers for third-party intellectual property infringement claims, which would increase the cost to us of an adverse ruling on such a claim.

The outcome of any litigation, regardless of its merits, is inherently uncertain. Any claims and lawsuits, and the disposition of such claims and lawsuits, could be time-consuming and expensive to resolve, divert management attention from executing our business plan, lead to attempts on the part of other parties to pursue similar claims and, in the case of intellectual property claims, require us to change our technology, change our business practices or pay monetary damages, or enter into short- or long-term royalty or licensing agreements.

Any adverse determination related to intellectual property claims or other litigation could prevent us from offering our service to others, could be material to our financial condition or cash flows, or both, or could otherwise adversely affect our operating results. In addition, depending on the nature and timing of any such dispute, a resolution of a legal matter could materially affect our future results of operation or cash flows or both.

We rely on trademark, copyright, trade secret laws, contractual restrictions and patent rights to protect our intellectual property and proprietary rights and if these rights are impaired, then our ability to generate revenue will be harmed.

If we fail to protect our intellectual property rights adequately, our competitors might gain access to our technology, and our business might be harmed. In addition, defending our intellectual property rights might entail significant expense. Any of our trademarks or other intellectual property rights may be challenged by others or invalidated

through administrative process or litigation. While we have some U.S. patents and pending U.S. patent applications, we may be unable to obtain patent protection for the technology covered in our patent applications. In addition, our existing patents and any patents issued in the future may not provide us with competitive advantages, or may be successfully challenged by third parties. Furthermore, legal standards relating to the validity, enforceability and scope of protection of intellectual property rights are uncertain. Effective patent, trademark, copyright and trade secret protection may not be available to us in every country in which our service is available. The laws of some foreign countries may not be as protective of intellectual property rights as those in the U.S., and mechanisms for enforcement of intellectual property rights may be inadequate. Accordingly, despite our efforts, we may be unable to prevent third parties from infringing upon or misappropriating our intellectual property.

We might be required to spend significant resources to monitor and protect our intellectual property rights. We may initiate claims or litigation against third parties for infringement of our proprietary rights or to establish the validity of our proprietary rights. Any litigation, whether or not it is resolved in our favor, could result in significant expense to us and divert the efforts of our technical and management personnel.

Our failure or inability to develop non-infringing technology or license the proprietary rights on a timely basis would harm our business.

Third parties may infringe or misappropriate our intellectual property and similar proprietary rights. In addition, other parties may assert infringement claims against us. Our products may infringe issued patents that may relate to our products. In addition, because patent applications in the United States are not publicly disclosed until the patent is issued, applications may have been filed which relate to our software products. We may be subject to legal proceedings and claims from time to time in the ordinary course of our business, including claims of alleged infringement of the patents and other intellectual property rights of third parties. Intellectual property litigation is expensive, time consuming, and could divert management's attention away from running our business. This litigation could also require us to develop non-infringing technology or enter into royalty or license agreements. These royalty or license agreements, if required, may not be available on acceptable terms, if at all, in the event of a successful claim of infringement.

Unknown software defects could disrupt our products and services and problems arising from our vendors' products or services could disrupt operations, which could harm our business and reputation.

Our product and service offerings depend on complex software, both internally developed and licensed from third parties. Complex software often contains defects or errors in translation or integration, particularly when first introduced or when new versions are released or localized for international markets. We may not discover software defects that affect our new or current services or enhancements until after they are deployed. It is possible that, despite testing by us, defects may occur in the software and we can give no assurance that our products and services will not experience such defects in the future. Furthermore, our customers generally use our products together with products from other companies. As a result, when problems occur in the integration or network, it may be difficult to identify the source of the problem. Even when our products do not cause these problems, these problems may cause us to incur significant warranty and repair costs, divert the attention of our engineering personnel from product development efforts and cause significant customer relations problems. These defects or problems could result in damage to our reputation, lost sales, product liability claims, delays in or loss of market acceptance of our products, product returns and unexpected expenses, and diversion of resources to remedy errors.

Our stock price has demonstrated volatility and continued market conditions may cause declines or fluctuations.

The price at which our common stock trades has been and will likely continue to be highly volatile and show wide fluctuations due to factors such as the following:

- concerns related to liquidity of our stock;
- actual or anticipated fluctuations in our operating results, our ability to meet announced or anticipated profitability goals and changes in or failure to meet securities analysts' expectations;
- announcements of technological innovations and/or the introduction of new services by us or our competitors;
- developments with respect to intellectual property rights and litigation, regulatory scrutiny and new legislation;
- conditions and trends in the Internet and other technology industries; and
- general market and economic conditions.

Furthermore, the stock market has recently and in the past experienced significant price and volume fluctuations that have affected the market prices for the common stock of technology companies, regardless of the specific operating performance of the affected company. These broad market fluctuations may cause the market price of our common stock to decline.

Our insiders who are significant stockholders may control the election of our board and may have interests that conflict with those of other stockholders.

Our directors and executive officers, together with their affiliates and members of their immediate families, beneficially owned, in the aggregate, approximately 41% of our outstanding capital stock as of our record date, December 31, 2013. As a result, acting together, this group has the ability to exercise significant control over most matters requiring our stockholders' approval, including the election and removal of directors and significant corporate transactions.

If we are unable to hire and retain key personnel, our business and results of operations would be negatively affected.

Our success will also depend in large part on the skills, experience and performance of our senior management, engineering, sales, marketing and other key personnel. The loss of the services of any of our senior management or other key personnel, including our Chief Executive Officer and co-founder, Ashutosh Roy, could harm our business. Additionally, an increase in attrition in the Indian workforce on which we rely for research and development would have significant negative effects on us and our results of operations. If we cannot hire and retain qualified personnel, our ability to expand our business would be impaired and our results of operations would suffer.

Periodic changes to our sales organization can be disruptive and may reduce our rate of growth.

We periodically change and make adjustments to our sales organization in response to market opportunities, competitive threats, management changes, product introductions or enhancements, acquisitions, sales performance, increases in sales headcount, cost levels and other internal and external considerations. In the past, these changes sometimes resulted in a temporary lack of focus and reduced productivity; these effects could recur in connection with any future sales changes we might undertake and our rate of revenue growth could be negatively affected. In addition, any significant change to the way we structure our compensation of our sales organization may be disruptive and may affect our revenue growth.

If our security measures are breached and unauthorized access is obtained to a customer's data or our data or our IT systems, our service may be perceived as not being secure, customers may curtail or stop using our service and we may incur significant legal and financial exposure and liabilities.

Our service involves the storage and transmission of customers' proprietary information, and security breaches could expose us to a risk of loss of this information, litigation and possible liability. These security measures may be breached as a result of third-party action, including intentional misconduct by computer hackers, employee error, malfeasance or otherwise and result in someone obtaining unauthorized access to our customers' data or our data, including our intellectual property and other confidential business information, or our IT systems. Additionally, third parties may attempt to fraudulently induce employees or customers into disclosing sensitive information such as user names, passwords or other information in order to gain access to our customers' data or our data or IT systems. Because the techniques used to obtain unauthorized access, or to sabotage systems, change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. In addition, our customers may authorize third party access to their customer data located in our cloud environment. Because we do not control the transmissions between customer authorized third parties, or the processing of such data by customer authorized third parties, we cannot ensure the integrity or security of such transmissions or processing. Any security breach could result in a loss of confidence in the security of our service, damage our reputation, negatively impact our future sales, disrupt our business and lead to legal liability.

The regulatory environment for and certain legal uncertainties in the operation of our business and our customer's business could impair our growth or decrease demand for our services or increase our cost of doing business.

The imposition of more stringent protections and/or new regulations and the application of existing laws to our business could burden our company and our business partners and customers. Further, the adoption of additional laws and regulations could limit the growth of our business and that of our business partners and customers. Any decreased generalized demand for our services, or the loss/decrease in business by a key partner or customer due to regulation or the expense of compliance with any regulation, could either increase the costs associated with our business or affect revenue, either of which could harm our financial condition or operating results.

We face increased regulatory scrutiny and potential criminal liability for our executives associated with various accounting and corporate governance rules promulgated under the Sarbanes-Oxley Act of 2002. We review and continue to monitor all of our accounting policies and practices, legal disclosure and corporate governance policies in accordance with the Sarbanes-Oxley Act of 2002, including those related to relationships with our independent accountants, enhanced financial disclosures, internal controls, board and board committee practices, corporate responsibility and loan practices, and intend to fully comply with such laws. Nevertheless, such increased scrutiny and penalties involve risks to both eGain and our executive officers and directors in monitoring and insuring compliance. A failure to properly navigate the legal disclosure environment and implement and enforce appropriate policies and procedures, if needed, could harm our business and prospects.

As Internet commerce continues to evolve, increasing regulation by federal, state or foreign agencies becomes more likely. For example, we believe increased regulation is likely in the area of data privacy. Our customers use our cloud service to store their customer data, which may contain contact and other personal or identifying information regarding their customers and contacts. Laws and regulations applying to the solicitation, collection, processing or use of personal or consumer information could affect our customer's ability to use and share data and, potentially restrict our ability to store and process data.

The costs of compliance with, and other burdens imposed by, such laws and regulations that are applicable to the businesses of our customers may limit the use and adoption of our service and reduce overall demand for it, or lead to significant fines, penalties or liabilities for any noncompliance with such privacy laws. Furthermore, privacy concerns may cause our customers' customers to resist providing the personal data necessary to allow our customers to use our service effectively and may reduce demand for our service. Even the perception of privacy concerns, whether or not valid, may inhibit market adoption of our service in certain industries.

Federal, state and foreign government bodies and agencies have adopted or are considering adopting laws and regulations regarding the collection, use and disclosure of personal information obtained from consumers and individuals. For example, in the United States regulations such as the Gramm-Leach-Bliley Act, which protects and restricts the use of consumer credit and financial information, and the Health Insurance Portability and Accountability Act of 1996, which regulates the use and disclosure of personal health information, impose significant requirements and obligations on businesses that may affect the use and adoption of our service. The European Union has also adopted a data privacy directive that requires member states to impose restrictions on the collection and use of personal data that, in some respects, are more stringent, and impose more significant burdens on subject businesses, than current privacy standards in the United States. Many other jurisdictions have similar stringent privacy laws and regulations. Our customers may demand that we incur significant costs to be compliant with all the relevant laws and regulations, which regulate their particular industry.

Additionally, because our services are accessible worldwide, certain foreign jurisdictions may claim that we are required to comply with their laws, even if we don't have a local entity, employees or infrastructure. Often, foreign data protection, privacy, and other laws and regulations are more restrictive than those in the United States. If we are required to comply with these foreign laws and regulations, our costs will increase which will affect our results of operations.

If we are unable to successfully detect weaknesses or errors in our internal controls, the trading price of our common stock may decline and adversely impact our ability to attract new and continued investors.

As a smaller reporting company, we are not required to include an attestation report from our independent registered public accounting firm regarding internal control over financial reporting. An adverse opinion on our internal control over financial reporting would indicate an inability to detect weaknesses or errors in our internal controls. If the Company fails to have effective internal control over financial reporting or is unable to complete any necessary modifications to its internal control reporting, investors could lose confidence in the accuracy and completeness of our financial reports and in the reliability of the Company's internal control over financial reporting, which could cause the price of our common stock to decline.

We may need to license third-party technologies and may be unable to do so on commercially reasonable terms.

To the extent we need to license third-party technologies, we may be unable to do so on commercially reasonable terms or at all. In addition, we may fail to successfully integrate any licensed technology into our products or services. Third-party licenses may expose us to increased risks, including risks associated with the integration of new technology, the diversion of resources from the development of our own proprietary technology, and our inability to generate revenue from new technology sufficient to offset associated acquisition and maintenance costs. Our inability to obtain and successfully integrate any of these licenses could delay product and service development until equivalent technology can be identified, licensed and integrated. This in turn would harm our business and operating results.

Changes to current accounting policies could have a significant effect on our reported financial results or the way in which we conduct our business.

Generally accepted accounting principles and the related accounting pronouncements, implementation guidelines and interpretations for some of our significant accounting policies are highly complex and require subjective judgments and assumptions. Some of our more significant accounting policies that could be affected by changes in the accounting rules and the related implementation guidelines and interpretations include:

- recognition of revenue;
- contingencies and litigation; and
- accounting for income taxes.

Changes in these or other rules, or scrutiny of our current accounting practices, or a determination that our judgments or assumptions in the application of these accounting principles were incorrect, could have a significant adverse effect on our reported operating results or the way in which we conduct our business.



We depend on broad market acceptance of our applications and of our business model.

We depend on the widespread acceptance and use of our applications as an effective solution for businesses seeking to manage high volumes of customer interactions across multiple channels, including Web, phone, email, print and in-person. While we believe the potential to be very large, we cannot accurately estimate the size or growth rate of the potential market for such product and service offerings generally, and we do not know whether our products and services in particular will achieve broad market acceptance. The market for customer engagement software is relatively new and rapidly evolving, and concerns over the security and reliability of online transactions, the privacy of users and quality of service or other issues may inhibit the growth of the Internet and commercial online services. If the market for our applications fails to grow or grows more slowly than we currently anticipate, our business will be seriously harmed.

Furthermore, our business model is premised on business assumptions that are still evolving. Our business model assumes that both customers and companies will increasingly elect to communicate via multiple channels, as well as demand integration of the online channels into the traditional telephone-based call center. Our business model also assumes that many companies recognize the benefits of a cloud delivery model and will seek to have their customer engagement software applications hosted by us. If any of these assumptions is incorrect or if customers and companies do not adopt digital technology in a timely manner, our business will be seriously harmed and our stock price will decline.

We may not be able to respond to the rapid technological change of the customer engagement software industry.

The customer engagement software industry is characterized by rapid technological change, changes in customer requirements and preferences, and the emergence of new industry standards and practices that could render our existing services, proprietary technology and systems obsolete. We must continually develop or introduce and improve the performance, features and reliability of our products and services, particularly in response to competitive offerings. Our success depends, in part, on our ability to enhance our existing services and to develop new services, functionality and technology that address the increasingly sophisticated and varied needs of prospective customers. If we do not properly identify the feature preferences of prospective customers, or if we fail to deliver product features that meet the standards of these customers, our ability to market our service and compete successfully and to increase revenue could be impaired. The development of proprietary technology and necessary service enhancements entails significant technical and business risks and requires substantial expenditures and lead-time. We may not be able to keep pace with the latest technological developments. We may also be unable to use new technologies effectively or adapt services to customer requirements or emerging industry standards or regulatory or legal requirements. More generally, if we cannot adapt or respond in a cost-effective and timely manner to changing industry standards, market conditions or customer requirements, our business and operating results will suffer.

We may be unable to respond to the rapid technological change and changing customer preferences in the online sales, marketing, customer service, and/or online consumer services industries and this may harm our business.

If we are unable, for technological, legal, financial or other reasons, to adapt in a timely manner to changing market conditions in the online sales, marketing, customer service and/or e-commerce industry or our customers' or Internet users' requirements or preferences, our business, results of operations and financial condition would be materially and adversely affected. Business on the Internet is characterized by rapid technological change. In addition, the market for online sales, marketing, customer service and expert advice solutions is relatively new. Sudden changes in customer and Internet user requirements and preferences, frequent new product and service introductions embodying new technologies, such as broadband communications, and the emergence of new industry standards and practices such as but not limited to security standards could render the LivePerson services and our proprietary technology and systems obsolete. The rapid evolution of these products and services will require that we continually improve the performance,

features and reliability of our services. Our success will depend, in part, on our ability to:

- enhance the features and performance of our services;
- develop and offer new services that are valuable to companies doing business online as well as Internet users; and
- respond to technological advances and emerging industry standards and practices in a cost-effective and timely manner.

If any of our new services, including upgrades to our current services, do not meet our customers' or Internet users' expectations, our business may be harmed. Updating our technology may require significant additional capital expenditures and could materially and adversely affect our business, results of operations and financial condition.

If new services require us to grow rapidly, this could place a significant strain on our managerial, operational, technical and financial resources. In order to manage our growth, we could be required to implement new or upgraded operating and financial systems, procedures and controls. Our failure to expand our operations in an efficient manner could cause our expenses to grow, our revenue to decline or grow more slowly than expected and could otherwise have a material adverse effect on our business, results of operations and financial condition

We may engage in future acquisitions or investments that could dilute our existing stockholders, cause us to incur significant expenses or harm our business.

We may review acquisition or investment prospects that we believe may complement our current business or enhance our technological capabilities. Integrating any newly acquired businesses or their technologies or products may be expensive and time-consuming, and may not result in benefits to our business. To finance any acquisitions, it may be necessary for us to raise additional funds through public or private financings. Additional funds may not be available on terms that are favorable to us, if at all, and, in the case of equity financings, may result in dilution to our existing stockholders. We may not be able to operate acquired businesses profitably. If we are unable to integrate newly acquired entities or technologies effectively, our operating results could suffer. Future acquisitions by us could also result in large and immediate write-offs, incurrence of debt and contingent liabilities, or amortization of expenses related to goodwill and other intangibles, any of which could harm our operating results.

Failure to comply with covenants in our loan facility may restrict our access to credit which could negatively impact our operations.

There are a number of affirmative and negative covenants under the Comerica Credit Facility, with the primary covenants being that we are required to maintain a minimum cash balance of \$1.0 million and we must maintain liquidity to debt ratio of at least 1.50 to 1.00. If we fail to comply with our covenants, Comerica can declare any outstanding amounts immediately due and payable and stop extending credit to us. If our access to credit were restricted in this way, our operations would suffer and negatively impact our business.

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

On September 14, 2009, we announced that our board of directors has approved a stock repurchase program under which we may purchase up to 1,000,000 shares of our common stock. The duration of the repurchase program is open-ended. Under the program, we can purchase shares of common stock from time to time through the open market and privately negotiated transactions at prices deemed appropriate by our management. Repurchases pursuant to our stock repurchase program could affect our stock price and increase its volatility. The existence of a stock repurchase program could also cause our stock price to be higher than it would be in the absence of such a program and could potentially reduce the market liquidity for our stock. Additionally, repurchases under our stock repurchase program will diminish our cash reserves, which could impact our ability to pursue possible future strategic opportunities and acquisitions and could result in lower overall returns on our cash balances. There can be no assurance that any stock repurchases will enhance stockholder value because the market price of our common stock may decline below the levels at which we repurchased shares of stock. Although our stock repurchase program is intended to enhance long-term stockholder value, short-term stock price fluctuations could reduce the program's effectiveness.

There were no repurchased shares of stock in the quarter ended December 31, 2013.



Item 6. Exhibits

Exhibits No.	Description of Exhibits
31.1	Rule 13a-15(e)/15d-15(e) Certification of Chief Executive Officer.
31.2	Rule 13a-15(e)/15d-15(e) Certification of Chief Financial Officer.
32.1(1)	Certification pursuant to 18.U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002 of Ashutosh Roy, Chief Executive Officer.
32.2(1)	Certification pursuant to 18.U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002 of Eric Smit, Chief Financial Officer.
101	Interactive Data Files Pursuant to Rule 405 of Regulation S-T: (i) Condensed Consolidated Balance Sheets as of December 31, 2013 and June 30, 2013, (ii) Condensed Consolidated Statements of Operations for the three and six months ended December 31, 2013 and 2012, (iii) Condensed Consolidated Statements of Cash Flows for the six months ended December 31, 2013 and 2012, (iv) Condensed Consolidated Statements of Comprehensive Income (Loss) for the three and six months ended December 31, 2013 and 2012 and (v) Notes to Condensed Consolidated Financial Statements
101.INS(2)	XBRL Instance Document
101.SCH(2)	XBRL Taxonomy Extension Schema Document
101.CAL(2)	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF(2)	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB(2)	XBRL Taxonomy Extension Label Linkbase Document
101.PRE(2)	XBRL Taxonomy Extension Presentation Linkbase Document
(1)	The material contained in this exhibit is not deemed “filed” with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after date hereof and irrespective of any general incorporation language contained in such filing.
(2)	In accordance with Rule 406T of Regulation S-T, the information furnished in these exhibits will not be deemed “filed” for purpose of Section 18 of the Exchange Act. Such exhibits will not be deemed to be incorporated by reference into any filing under the Securities Act or Exchange Act.

SIGNATURES

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

Dated: February 12, 2014 eGAIN CORPORATION

By /s/ Eric N. Smit  
Eric N. Smit  
Chief Financial Officer  
(Duly Authorized Officer and  
Principal Financial and Accounting Officer)

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