Mattersight Corp
Form 10-K
March 16, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2016

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number 0-27975

Mattersight Corporation

(Exact Name of Registrant as Specified in Its Charter)

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

200 W. Madison Street, Suite 3100

Chicago, Illinois 60606

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

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

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

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

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

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

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

The aggregate market value of Common Stock held by non-affiliates of the registrant, based upon the closing price per share of registrant's Common Stock on June 30, 2016, as reported by The NASDAQ Stock Market LLC, is approximately $67,886,971.

The number of shares of the registrant's Common Stock outstanding as of March 6, 2017 was 32,568,613.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of Mattersight's Proxy Statement for its 2017 Annual Meeting of Stockholders, to be filed with the Securities and Exchange Commission within 120 days after the end of Mattersight's fiscal year, are incorporated herein by reference into Part III where indicated; provided, that if such Proxy Statement is not filed with the Securities and Exchange Commission within 120 days after the fiscal year end covered by this Annual Report on Form 10-K, an amendment to this Annual Report on Form 10-K shall be filed no later than the end of such 120-day period.

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PART I

Forward-Looking Statements

Statements in this Annual Report on Form 10-K that are not historical facts are “forward-looking statements” and are made pursuant to the safe harbor provisions of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). These forward-looking statements, which may be identified by use of words such as “plan,” “may,” “might,” “believe,” “expect,” “intend,” “could,” “would,” “should,” and other words and terms of similar meaning, in connection with any discussion of our prospects, financial statements, business, financial condition, revenues, results of operations, or liquidity, involve risks and uncertainties that could cause actual results to differ materially from those described in the forward-looking statements. In addition to other factors and matters contained or incorporated in this document, important factors that could cause actual results or events to differ materially from those indicated by such forward-looking statements include, without limitation, those noted under Risk Factors included in Part I Item 1A of this Annual Report on Form 10-K for the year ended December 31, 2016, including the following:

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

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

Item 1. Business

Overview

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

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

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

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

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

Types of Revenue

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

Subscription Revenue

Subscription revenue consists of revenue derived from Mattersight’s Behavioral Analytics service offerings, including predictive behavioral routing, performance management, quality assurance, predictive analytics, and marketing managed services revenue derived from the performance of services on a continual basis.

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

Other Revenue

Other revenue consists of deployment revenue, professional services revenue, and reimbursed expenses revenue.

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Deployment revenue consists of planning, deployment, and training fees derived from Behavioral Analytics contracts. These fees, which are considered to be installation fees related to Behavioral Analytics subscription contracts, are deferred until the installation is complete and are then recognized over the applicable subscription or pilot period. Installation costs incurred are deferred up to an amount not to exceed the amount of deferred installation revenue and additional amounts that are recoverable based on the contractual arrangement. These costs are included in prepaid expenses and other long-term assets. Such costs are amortized over the subscription period. Costs in excess of the foregoing revenue amount are expensed in the period incurred.

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

Reimbursed expenses revenue includes billable costs related to travel and other out-of-pocket expenses incurred while performing services for our clients. An equivalent amount of reimbursable expenses is included in total cost of other revenue.

Business Segments

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

International Operations

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

Methods of Distribution

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

Intellectual Property Rights

General

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

Patents

As of December 31, 2016, we held thirty-one U.S. patents and one European patent and have applied for over twenty patents. These patents cover a broad range of our analytics capabilities, including methods for analyzing language to

assess customer personality, routing customers based on personality in real time, optimizing routing to improve agent performance, and analyzing data to improve employee performance. Our issued patents will expire between 2025 and 2034.

Trademarks

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

Licenses

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

Seasonality

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

Clients

During 2016, our five and ten largest clients accounted for 73% and 87% of our total revenue, respectively. During 2015, our five and ten largest clients accounted for 73% and 89% of our total revenue, respectively. During 2014, our five and ten largest clients accounted for 75% and 91% of our total revenue, respectively. In 2016, there were three clients that accounted for 10% or more of total revenue: United HealthCare Services, Inc.; Progressive Casualty Insurance Company; and CVS Caremark Corporation, which accounted for 33%, 15%, and 11% of total revenue, respectively. In 2015, there were three clients that accounted for 10% or more of total revenue: United HealthCare Services, Inc.; Progressive Casualty Insurance Company; and CVS Caremark Corporation, which accounted for 31%, 15%, and 13% of total revenue, respectively. In 2014, there were three clients that accounted for 10% or more of total revenue: United HealthCare Services, Inc.; Progressive Casualty Insurance Company; and Health Care Service Corporation, which accounted for 25%, 20%, and 11% of total revenue, respectively. For 2016, 2015, and 2014, ten, nine, and seven clients, respectively, each accounted for over $1 million of total revenue. See Note Two—Summary of Significant Accounting Policies of the Notes to Consolidated Financial Statements included in Part II Item 8 of this Annual Report on Form 10-K.

Competition

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

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

Environmental Issues

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

Employees

As of December 31, 2016, we employed 265 persons, none of whom is represented by a union. We consider our employee relations to be good.

Available Information and Other

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

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

Item 1A. Risk Factors

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

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

As of December 31, 2016, we had an accumulated deficit of $263.1 million. We expect to continue to use cash and incur operating expenses to support our growth, including costs associated with recruiting, training, and managing our sales force, costs to develop and acquire new technology, and promotional costs associated with reaching new clients. These investments, which typically are made in advance of revenue, may not yield an offsetting increase in revenue. As a result of these factors, our future revenue and income potential is uncertain. Even if we achieve profitability, we may not be able to sustain or increase profitability on a quarterly or annual basis. Our failure to become and remain profitable would depress our value and could impair our ability to raise capital, expand our business, maintain our product development efforts, diversify our product offerings, or continue our operations. A decline in our value could also cause you to lose all or part of your investment.

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

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

- Our ability to continue to grow our revenue and meet anticipated growth targets;
- Our ability to maintain our current relationships, and develop new relationships, with clients, service providers, and business partners;
- Unanticipated cancellations or deferrals of, or reductions in the scope of, our major Behavioral Analytics contracts;
- The length of the sales cycle associated with our solutions;

- Our ability to successfully introduce new, and upgrade our existing, service offerings for clients;
- Our ability to respond effectively to competition;
- The mix of our service offerings sold in any period;
- The cost and potential outcomes of litigation, which could have a material adverse effect on our business;
- Future accounting pronouncements or changes in our accounting policies; and
- General economic conditions.

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

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

We derive, and expect to continue to derive for the foreseeable future, a significant portion of our total revenue from a limited number of clients. See Clients in Part I Item 1 and 2016 Compared 2015 included in Management's Discussion and Analysis of Financial Condition and Results of Operations in Part II Item 7 of this Annual Report on Form 10-K for more information on the portion of our total revenue derived from these clients. To the extent that any significant client uses less of our services or terminates its relationship with us, as may occur as clients respond to conditions affecting their own businesses, our total revenue could decline substantially and that could significantly harm our business. In addition, because a high percentage of our revenue is dependent on a relatively small number of clients, delayed payments by a few of our larger clients could result in a reduction of our available cash, which in turn may cause fluctuation in our Days Sales Outstanding.

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

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

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

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

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

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

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

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

We operate in a highly competitive and rapidly changing market and compete with a variety of organizations that offer services that may be viewed as similar to ours. These competitive organizations include data analytics solutions

providers, voice recording and voice analytic service providers and software licensors, call routing solution providers, and strategic consulting firms. We compete with these organizations on factors such as expertise, price, and capacity.

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

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

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

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

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

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

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

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

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

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

In providing Behavioral Analytics, we record and analyze telephone calls and other interactions between our clients' call center and back office agents and their customers. These interactions may contain numerous references to highly

sensitive confidential or personally-identifiable data of the customers of our clients, and many of our clients are required to comply with Federal and state laws concerning privacy and security, such as the Health Insurance Portability and Accountability Act of 1996 and the Gramm-Leach-Bliley Act of 1999. In addition, we have made certain contractual commitments to our clients regarding this confidential data.

In light of the highly-confidential information that we record and maintain, our clients require that we agree not to limit our liability in the event of a security breach resulting in the loss of, or unauthorized access to, personally-identifiable or other confidential data. As a result, the disclosure or loss of such data despite the extensive precautions we undertake could result in the considerable diminution of our business and prospects and could subject us to substantial liability.

In addition, the laws, regulations, and industry standards governing these matters are changing rapidly. It is possible that the resources we devote to comply with such laws, regulations, and industry standards, and our clients' particular requirements, could

increase materially. In our contracts, we generally agree to indemnify our clients for expenses and liabilities resulting from unauthorized access to or disclosure of confidential data, such as those arising from data breach notification requirements. These indemnity obligations are generally not subject to contractual limitations on liability. As a result, the amount of liability we could incur in connection with these indemnity obligations could exceed the revenue we receive from the client under the applicable contract.

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

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

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

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

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

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

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

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

Our ability to protect our software, algorithms, databases, methodologies, and other intellectual property is important to our success and our competitive position. We view as proprietary the software (including source code), algorithms, databases, analysis, and other ideas, concepts, and developments that we create in order to provide, improve, and enhance our service offerings, as well as the work product we create in the course of providing services for clients. We seek to protect our intellectual property rights in these developments and work product by applying for patents,

copyrights, and trademarks, as appropriate, as well as by enforcing applicable trade secret laws and contractual restrictions on scope of use, disclosure, copying, reverse engineering, and assignment.

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

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

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

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

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

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

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

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

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

In the event, for any reason, we need to raise additional funds in the future, through public or private debt or equity financings, such funds may not be available or may not be available on terms favorable to us. Additionally, the terms of the Loan and Security Agreement we entered into with Hercules Capital, Inc. (Hercules) on August 1, 2016 (the Loan Agreement) limits our ability to enter into a public or private debt financing. The failure by us to obtain such financing, if needed, may have a material adverse effect upon our business, financial condition, results of operations, and prospects.

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

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

- actual or anticipated changes in our earnings or fluctuations in our operating results or in the expectations of securities analysts;
- price and volume fluctuations in the overall stock market from time to time;
- significant volatility in the market price and trading volume of comparable companies;

- changes in the market perception of behavioral and personality-based software products generally or in the effectiveness of our solutions in particular;
- announcements of technological innovations, new products, strategic alliances, or significant agreements by us or by our competitors;
- litigation involving us;
- investors' general perception of us;
- changes in general economic, industry, and market conditions and trends; and
- recruitment or departure of key personnel.

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

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

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

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

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

Item 1B. Unresolved Staff Comments.
Not applicable.

Item 2. Properties.
Our principal physical properties employed in our business consist of our leased office facilities in Chicago, Illinois; Edina, Minnesota; and Austin, Texas. Our executive offices are located at 200 West Madison Street, Suite 3100, Chicago, Illinois 60606. The initial lease term for this property, which became effective on July 1, 2015, terminates on July 31, 2022. The lease includes one five-year renewal option.

Our total employable space is approximately 61,000 square feet. We do not own any real estate. We believe that our leased facilities are appropriate for our current business requirements.

Item 3. Legal Proceedings.
From time to time, we have been subject to legal claims arising in connection with its business and the results of these claims, when they arise, cannot be predicted with certainty. There are no asserted claims against us that, in the opinion

of management, if adversely decided, would have a material effect on our business, financial position, results of operations, or prospects.

Item 4. Mine Safety Disclosures.
Not applicable.

PART II.

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

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

	High	Low
2016		
Fourth Quarter	$4.40	$3.00
Third Quarter	4.65	3.50
Second Quarter	4.38	3.23
First Quarter	6.70	3.85
2015		
Fourth Quarter	$8.10	$6.25
Third Quarter	8.00	5.59
Second Quarter	7.49	5.56
First Quarter	7.50	4.75

There were approximately 142 owners of record of Common Stock as of March 6, 2017. The last reported sale price of Common Stock on the NASDAQ Global Market on March 6, 2017 was $3.75.

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

Sale of Unregistered Securities

In connection with our Loan Agreement with Hercules, we also entered into a Warrant Agreement with Hercules evidencing Hercules's right to purchase shares of Common Stock at an exercise price of $3.50 per share (the Warrant). The Warrant initially is exercisable for 357,142 shares of Common Stock. If tranche 3 is fully funded under the Loan Agreement, then the Warrant automatically will become exercisable for an additional 71,428 shares of Common Stock. The exercise price and the number and type of shares underlying the Warrant are subject to adjustment in the event of specified merger events, a reclassification of Common Stock, a subdivision or combination of Common Stock, or in the event of certain dividend payments. The Warrant is exercisable until August 1, 2023. Upon exercise, the aggregate exercise price may be paid, at Hercules's election, in cash or on a net issuance basis, based upon the fair market value of Common Stock at the time of exercise.

The issuance of the Warrant was exempt from the registration requirements of the Securities Act of 1933, as amended, pursuant to an exemption provided by Section 4(a)(2) thereof as a transaction by an issuer not involving a public

offering.

Stock Performance Graph

The following graph compares the cumulative total stockholder return on Common Stock with the cumulative total return of (i) a peer group of other publicly-traded information-technology consulting companies selected by us (the Peer Group Index), and (ii) the NASDAQ Global Market Index. Cumulative total stockholder return is based on the period from January 1, 2012 through December 31, 2016. The comparison assumes that $100 was invested on January 1, 2012 in each of Mattersight Common Stock, the Peer Group Index, and the NASDAQ Global Market Index, and that any and all dividends were reinvested.

Comparative Cumulative Total Return for Mattersight Corporation,

Peer Group Index, and NASDAQ Global Market Index

	12/31/11	12/31/12	12/31/13	12/31/14	12/31/15	12/31/16
Mattersight Common Stock	$ 100.00	$ 106.88	$ 103.01	$ 134.41	$ 141.08	$ 79.56
Peer Group Index[(1)]	100.00	100.29	132.45	172.78	156.20	166.73
NASDAQ Global Market Index	100.00	116.41	165.47	188.69	200.32	216.54

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

Repurchase of Equity Securities

The following table provides information relating to our repurchase of shares of its Common Stock in the fourth quarter of 2016. These repurchases reflect shares withheld upon vesting of restricted stock to satisfy tax-withholding obligations.

Period	Total Number of Shares Purchased	Average Price Paid Per Share
October 1, 2016 – October 31, 2016	10,460	$ 4.02
November 1, 2016 – November 30, 2016	18,403	$ 3.72
December 1, 2016 – December 31, 2016	688	$ 3.70
Total	29,551	$ 3.82

Dividends

Historically, we have not paid cash dividends on our Common Stock, and we do not expect to do so in the future. Under the terms of its certificate of designations, our 7% Series B Convertible Preferred Stock (the Series B Stock) accrues dividends at a rate of 7% per year, payable semi-annually in January and July if declared by our board of directors. If not declared, unpaid dividends are cumulative and accrue at the rate of 7% per annum. Total accrued dividends for the periods July 1, 2012 through December 31, 2016 are $2.6 million, which will continue to be accrued

until they are declared by the board of directors. Payment of future dividends on the Series B Stock will be determined by our board of directors based on our outlook and macroeconomic conditions.

The amount of each dividend accrual would decrease by any conversions of the Series B Stock into Common Stock, as Series B Stock conversions require us to pay accrued but unpaid dividends at the time of conversion. Conversions of Series B Stock became

permissible at the option of the holder after June 19, 2002. For further discussion see Liquidity and Capital Resources included in Part II, Item 7 of this Annual Report on Form 10-K.

Equity Compensation Information

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

Item 6. Selected Financial Data.

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

	(In thousands, except per share data)[1]				
	December 31, 2016	December 31, 2015	December 31, 2014	December 31, 2013	December 31, 2012
Total revenue	$42,097	$ 39,912	$ 30,319	$ 34,494	$ 33,863
Loss from continuing operations	$(20,977)	$ (15,681)	$ (14,232)	$ (11,172)	$ (15,470)
Net loss available to common stockholders	$(21,563)	$ (16,269)	$ (14,821)	$ (11,761)	$ (15,881)
Basic loss from continuing operations per share	$(0.86)	$ (0.70)	$ (0.74)	$ (0.70)	$ (1.01)
Total assets	$45,564	$ 40,402	$ 32,078	$ 30,749	$ 31,362
Long-term debt	$20,839	$ —	$ —	$ —	$ —
Series B Stock	$8,354	$ 8,388	$ 8,406	$ 8,411	$ 8,411
Capital leases	$3,584	$ 3,433	$ 2,813	$ 2,832	$ 2,305

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

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

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

Overview

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

Business Metrics

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

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

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

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

Performance Highlights

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

	2016 (in thousands, except percentage data)				
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Year
ACV bookings	5.4	4.4	4.7	6.4	20.9
Rolling four quarters ACV bookings	25.1	23.7	21.5	20.9	20.9
Backlog	17.9	23.1	19.2	12.6	12.6
Gross Margin	68%	65%	67%	69%	67%

	2015 (in thousands, except percentage data)
	Year

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	
ACV bookings	3.1	5.8	6.9	7.0	22.7
Rolling 4 quarters ACV bookings	17.1	19.0	22.6	22.7	22.7
Backlog	8.1	10.0	11.7	15.1	15.1
Gross Margin	72%	73 %	76 %	72 %	73 %

Critical Accounting Policies and Estimates

Our management's discussion and analysis of financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The preparation of these financial statements requires us to make estimates and judgments on an ongoing basis. Actual results may differ from these estimates under different assumptions or conditions.

The fiscal year-end dates referenced herein for 2016, 2015, and 2014, are December 31, 2016, December 31, 2015, and December 31, 2014, respectively.

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

Revenue Recognition

Subscription Revenue

Subscription revenue consists of revenue derived from Mattersight's Behavioral Analytics service offerings, including predictive behavioral routing, performance management, quality assurance, predictive analytics, and marketing managed services revenue derived from the performance of services on a continual basis.

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

Other Revenue

Other revenue consists of deployment revenue, professional services revenue, and reimbursed expenses revenue.

Deployment revenue consists of planning, deployment, and training fees derived from Behavioral Analytics contracts. These fees, which are considered to be installation fees related to Behavioral Analytics subscription contracts, are deferred until the installation is complete and are then recognized over the applicable subscription or pilot period. Installation costs incurred are deferred up to an amount not to exceed the amount of deferred installation revenue and additional amounts that are recoverable based on the contractual arrangement. These costs are included in prepaid expenses and other long-term assets. Such costs are amortized over the subscription period. Costs in excess of the foregoing revenue amount are expensed in the period incurred.

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

Reimbursed expenses revenue includes billable costs related to travel and other out-of-pocket expenses incurred while performing services for our clients. An equivalent amount of reimbursable expenses is included in total cost of other revenue.

Unearned Revenue

Unearned revenue consists of billings or payments received in advance of revenue recognition for Behavioral Analytics contracts. Unearned revenue is recognized as revenue when the applicable recognition criteria are met.

Allowance for Doubtful Accounts

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

condition of our clients deteriorates.

Stock Warrants

In accordance with ASC 480-10, Distinguishing Liabilities from Equity, we classified certain warrants to purchase Common Stock that do not meet the requirements for classification as equity, as liabilities. Such liabilities are initially recorded at fair value with subsequent changes in fair value recorded as a component of gain or loss on warrant liability on the consolidated statements of operations in each reporting period. See Note Seventeen — Fair Value Measurements of the Notes to Consolidated Financial Statements included in Part II Item 8 of this Annual Report on Form 10-K.

Stock-Based Compensation

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

Goodwill

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

Intangible Assets

Intangible assets reflect costs related to patent and trademark applications, marketing managed services customer relationships, and the purchase of certain intellectual property rights. The costs related to patent and trademark applications and the purchase of certain intellectual property are amortized over 120 months. The other intangible assets are fully amortized.

Income Taxes

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

We use an asset and liability approach for financial accounting and reporting of income taxes. Deferred income taxes are provided when tax laws and financial accounting standards differ with respect to the amount of income for the year, the basis of assets and liabilities and for tax loss carryforwards.

We may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. Significant judgment is used to determine the likelihood of the benefit.

Other Significant Accounting Policies

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

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Business Outlook

Based on research from third-party analysts, we believe the call center industry is ripe for disruption and innovation. We believe what the call center was designed to accomplish and how it was measured are parts of an outdated mode of business that is disconnected from the needs of today's consumer. In fact, research from the Corporate Executive Board suggests that any call center interaction is four times more likely to drive customer disloyalty than increased loyalty. Given a rise in self-service, these interactions are only becoming more complex and fraught with greater risk.

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

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

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

Results of Operations

	Year Ended December 31,			Year Ended December 31,		
(Dollars in millions)	2016	2015	Change	2015	2014	Change
Total revenue	$42.1	$39.9	(6)%	$39.9	$30.3	32 %
Total cost of revenue, exclusive of depreciation and amortization	13.8	10.7	29 %	10.7	9.4	14 %
Gross margin	28.3	29.2	(3)%	29.2	20.9	40 %
Other operating expenses	47.1	44.3	6 %	44.3	33.9	31 %
Operating loss	18.8	15.1	25 %	15.1	13.0	16 %
Non-operating expenses	2.1	0.6	260 %	0.6	1.2	(52)%
Net loss	21.0	15.7	34 %	15.7	14.2	10 %

Revenue

2016 Compared with 2015

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

Our top five clients accounted for 73% of total revenue in 2016 and 73% of total revenue in 2015. Our top ten clients accounted for 87% of total revenue in 2016 and 89% of total revenue in 2015. In 2016 and 2015, three clients each accounted for 10% or more of total revenue. In 2016, United HealthCare Services, Inc., CVS Caremark Corporation, and Progressive Casualty Insurance Company accounted for 33%, 15%, and 11% of total revenue, respectively. In 2015, United HealthCare Services, Inc., Progressive Casualty Insurance Company, and CVS Caremark Corporation accounted for 31%, 15%, and 13% of total revenue, respectively. Higher concentration of revenue with a single client or a limited group of clients creates increased revenue risk if one of these clients significantly reduces its demand for our services.

2015 Compared with 2014

Total revenue increased by $9.6 million in 2015 when compared with 2014. The increase consisted of a $9.7 million increase in subscription revenue offset by a $0.1 million decrease in other revenue. The increase in subscription revenue in 2015 was primarily due to the increased subscription fees associated with the conversion of several Behavioral Analytics deployments to the subscription phase of the contract, as well as expansion of user counts in our existing client base. Other revenue decreased primarily due to reduced recognition of deployment fees.

Our top five clients accounted for 73% of total revenue in 2015 and 75% of total revenue in 2014. The top ten clients accounted for 89% of total revenue in 2015 and 91% of total revenue in 2014. In 2015 and 2014, three clients each accounted for 10% or more of total revenue. In 2015, United HealthCare Services, Inc., Progressive Casualty Insurance Company, and CVS Caremark Corporation accounted for 31%, 15%, and 13% of total revenue, respectively. In 2014, United HealthCare Services, Inc., Progressive Casualty Insurance Company, and HealthCare Service Corporation accounted for 25%, 20%, and 11% of total revenue, respectively. Higher concentration of revenue with a single client or a limited group of clients creates increased revenue risk if one of these clients significantly reduces its demand for our services.

Total Cost of Revenue, Exclusive of Depreciation and Amortization

2016 Compared with 2015

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

2015 Compared with 2014

Total costs of revenue consisted of $8.1 million of subscription revenue costs and $2.6 million of other revenue costs. Cost of subscription revenue was $8.1 million, or 22% of subscription revenue, in 2015, when compared with $6.8 million, or 26% of subscription revenue, in 2014. The $1.3 million increase in cost was primarily due to increased revenue and incremental personnel costs. The favorable decrease in percentage was primarily due to better leverage of our cost structure supporting our subscription clients.

Other Operating Expenses

2016 Compared with 2015

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

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

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

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

2015 Compared with 2014

Other operating expenses increased in 2015 when compared with 2014 primarily as a result of a $4.7 million increase in sales and marketing expenses, $2.6 million increase in general and administrative expenses, a $1.4 million increase in depreciation and amortization, and a $1.3 million increase in research and development expenses.

Sales and marketing expenses increased $4.7 million in 2015 when compared with 2014. The increase was primarily due to increased compensation costs related to the expansion of our sales and marketing teams.

General and administrative expenses increased $2.6 million in 2015 when compared with 2014. The increase was primarily due to higher compensation, and recruiting and legal expenses.

Depreciation and amortization increased $1.4 million in 2015 when compared with 2014. The increase was primarily due to higher capital expenditures and losses on fixed asset disposals in 2015. Amortization of intangibles increased $0.4 million due to the purchase of certain intellectual property rights.

Research and development expenses increased $1.3 million in 2015 when compared with 2014. The increase was primarily due to higher compensation and outside services costs.

Non-Operating Expenses

2016 Compared with 2015

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

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

2015 Compared with 2014

Interest and other expense decreased $0.5 million in 2015 when compared with 2014, primarily due to $0.5 million write-off of deferred financing fees in connection with the termination of our Principal Financial Group Inc. credit facility in 2014.

Income Tax Provision

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

2016 Compared with 2015

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

2015 Compared with 2014

The income tax provision was less than $0.1 million in 2015 and 2014. As of December 31, 2015 and 2014, total net deferred tax assets of $75.8 million and $71.0 million, respectively, were fully offset by a valuation allowance.

Liquidity and Capital Resources

Sources and Uses of Cash

Our principal capital requirements are to fund working capital needs, capital expenditures for Behavioral Analytics and infrastructure requirements, and other revenue generation and growth investments. Our principal capital resources consisted of cash and cash equivalents of $12.5 million and $15.4 million at December 31, 2016 and December 31, 2015, respectively.

Net cash used in operating activities increased by $11.4 million in 2016 when compared with 2015. The increase in net cash used in operating activities was largely attributable to increases in cost of revenue, and sales and marketing expenses, as well as a $4.2 million increase in restricted cash used to collateralize letters of credit for equipment leasing. Cash used in investing activities decreased by $1.0 million in 2016 when compared with 2015 primarily due to a decrease in capital expenditures. During 2015, capital expenditures included a one-time investment in relocating our corporate headquarters. Net cash provided by financing activities increased by $6.3 million, primarily as a result of $22.5 million in debt proceeds from Hercules (see Credit Facility below). In 2015 we received $15.9 million in proceeds from the sale of 2,728,712 shares of common stock pursuant to the Common Stock Purchase Agreement executed on July 22, 2015.

Historically, we have not paid cash dividends on our common stock, and we do not expect to do so in the future. Our Series B stock accrues dividends at a rate of 7% per year, payable semi-annually in January and July if declared by our board of directors. If not declared, unpaid dividends are cumulative and accrue at the rate of 7% per year. The board of directors has not declared a dividend payment on the Series B stock, which has been accrued, from July 1, 2012 through December 31, 2016 (the aggregate amount of these dividends was approximately $2.6 million). Payment of future dividends on the Series B stock will be determined by the board of directors based on our business outlook and macroeconomic conditions and is subject to approval by Hercules under the terms of our new secured loan agreement. The amount of each dividend accrual will be decreased by any conversions of the Series B stock into common stock, as such conversions require us to pay accrued but unpaid dividends at the time of conversion. Conversions of Series B stock are at the option of the holder.

Liquidity

As of December 31, 2016, our near-term capital resources consisted of our current cash balance, together with anticipated future cash flows, financing from capital leases, and borrowing capacity (see Credit Facility below). Our balance of cash and cash equivalents was $12.5 million as of December 31, 2016. Restricted cash of $4.2 million was used as collateral for letters of credit issued to support our equipment leasing activities. On March 1, 2017, we completed an offering of 5,328,187 shares of our unregistered common stock for gross proceeds of $16.0 million (or approximately $14.9 million after commissions, but before other expenses).

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

Credit Facility

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

intellectual property.

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

kind interest added as principal) also will be due, depending upon whether we prepay in year one, in year two, or after year two of the closing date, respectively. In addition, we will be required to prepay all such outstanding amounts and such prepayment charge upon the occurrence of a change in control.

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

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

Accounts Receivable Customer Concentration

As of December 31, 2016, two clients, United HealthCare Services, Inc., and CVS Caremark Corporation, accounted for 41% and 27% of total gross accounts receivable, respectively. Of these amounts, we have collected 81% from United HealthCare Services, Inc., and 52% from CVS Pharmacy, Inc., through March 6, 2017. Of the total December 31, 2016 gross accounts receivable, we have collected 56% as of March 6, 2017. Because we have a high percentage of our revenue dependent on a relatively small number of clients, delayed payments by a few of our larger clients could result in a reduction of our available cash.

Capital Lease Obligations

We are a party to capital lease agreements with leasing companies to fund our ongoing equipment requirements. Capital lease obligations were $3.6 million as of December 31, 2016 and $3.4 million as of December 31, 2015. We expect to incur new capital lease obligations of between $2.6 million to $3.1 million for 2017 as we continue to expand our investment in the infrastructure for Behavioral Analytics.

Contractual Obligations

Cash will be required for operating leases and non-cancellable purchase obligations, as well as various commitments reflected as liabilities on our balance sheet as of December 31, 2016. These commitments are as follows:

		Less			More
(In millions)		Than 1	1 – 3	3 – 5	Than 5
Contractual Obligations	Total	Year	Years	Years	Years
Long-term debt	$29.7	$ 3.1	$20.6	$ 6.0	$ —
Operating leases	3.9	1.1	1.3	1.0	0.5
Capital leases	3.9	2.0	1.9	—	—
Purchase obligations	4.7	3.9	0.8	—	—
Total	$42.2	$ 10.1	$24.6	$ 7.0	$ 0.5

Leases

The amounts set forth in the chart above reflect future principal, interest, and executory costs of the leases entered into by us for technology and office equipment, as well as office and data center space. Liabilities for the principal portion

of the capital lease obligations are reflected on our balance sheet as of December 31, 2016 and December 31, 2015.

Purchase Obligations

Purchase obligations include $4.7 million of commitments reflected as liabilities on our balance sheet as of December 31, 2016, Purchase obligations include $3.8 million of commitments reflected as liabilities on our balance sheet as of December 31, 2015, as well as $0.9 million of non-cancellable obligations to purchase goods or services in the future.

Letters of Credit

There were $4.2 million of standby letters of credit issued as collateral for capital leases as of December 31, 2016.

Off-Balance Sheet Arrangements

During 2016 and 2015, we did not have any relationships with unconsolidated financial partnerships, such as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

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

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

We also have interest rate risk with respect to changes in variable interest rates on our term loan and other borrowings, capital leases, and cash and cash equivalents. Interest on the secured loan agreement with Hercules is currently based on either the greater of (i) 9.75% plus the prime rate minus 3.50%, the prime rate varies in accordance with prevailing market conditions or (ii) 9.75%, A change in interest rate impacts the interest and other borrowing costs and cash flows.

Item 8. Financial Statements and Supplementary Data.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS OF MATTERSIGHT CORPORATION

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders

Mattersight Corporation

We have audited the accompanying consolidated balance sheets of Mattersight Corporation (a Delaware corporation) and subsidiaries (the Company) as of December 31, 2016 and 2015, and the related consolidated statements of operations, comprehensive loss, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2016. Our audits of the basic consolidated financial statements included the financial statement schedule listed in the index appearing under Schedule II – Valuation of Qualifying Accounts. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mattersight Corporation and subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2016 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2016, based on criteria established in the 2013 Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 16, 2017, expressed an unqualified opinion.

/s/ GRANT THORNTON LLP

Chicago, Illinois
March 16, 2017

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders

Mattersight Corporation

We have audited the internal control over financial reporting of Mattersight Corporation (a Delaware corporation) and subsidiaries (the Company) as of December 31, 2016, based on criteria established in the 2013 Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting in Item 9A. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in the 2013 Internal Control—Integrated Framework issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of the Company as of and for the year ended December 31, 2016, and our report dated March 16, 2017, expressed an unqualified opinion on those financial statements.

/s/ GRANT THORNTON LLP

Chicago, Illinois

March 16, 2017

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MATTERSIGHT CORPORATION

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

	December 31, 2016	December 31, 2015
ASSETS:		
Current Assets:		
Cash and cash equivalents	$12,538	$15,407
Receivables net of allowances of $311 and $24, respectively	8,508	4,863
Prepaid expenses	4,440	4,582
Other current assets	296	235
Total current assets	25,782	25,087
Equipment and leasehold improvements, net of accumulated depreciation and amortization of $19,748 and $14,805, respectively	9,576	8,523
Goodwill	972	972
Intangibles assets, net of amortization of $3,820 and $3,351, respectively	3,201	3,353
Other long-term assets (includes $4,210 in restricted cash at December 31, 2016)	6,033	2,467
Total assets	$45,564	$40,402
LIABILITIES AND STOCKHOLDERS' EQUITY:		
Current Liabilities:		
Short-term debt	$738	$—
Accounts payable	1,835	1,223
Accrued compensation and related costs	2,302	2,761
Unearned revenue	4,911	6,378
Capital leases	1,982	1,819
Other current liabilities	3,374	1,796
Total current liabilities	15,142	13,977
Long-term debt	20,839	—
Long-term unearned revenue	757	1,597
Long-term capital leases	1,602	1,614
Other long-term liabilities	5,945	5,689
Total liabilities	44,285	22,877
Series B convertible preferred stock, $0.01 par value; 5,000,000 shares authorized and designated; 1,637,948 and 1,644,768 shares issued and outstanding at December 31, 2016 and December 31, 2015, respectively, with a liquidation preference of $10,985 and $10,443 at December 31, 2016 and December 31, 2015, respectively	8,354	8,388
Stockholders' Equity:		
Preferred stock, $0.01 par value; 35,000,000 shares authorized; none	—	—

issued and outstanding		
Common stock, $0.01 par value; 50,000,000 shares authorized;		
27,511,361 and 27,636,853 shares issued at December 31, 2016 and		
December 31, 2015, respectively; and 26,622,706 and 25,849,876		
outstanding at December 31, 2016 and December 31, 2015, respectively	275	276
Additional paid-in capital	264,214	264,212
Accumulated deficit	(263,062)	(242,085)
Treasury stock, at cost, 888,655 and 1,786,977 shares at		
December 31, 2016 and December 31, 2015, respectively	(4,455)	(9,239)
Accumulated other comprehensive loss	(4,047)	(4,027)
Total stockholders' (deficit) equity	(7,075)	9,137
Total liabilities and stockholders' equity	$45,564	$40,402

See accompanying notes to consolidated financial statements.

MATTERSIGHT CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	Year Ended December 31,		
	2016	2015	2014
Revenue:			
Subscription revenue	$38,720	$36,091	$26,372
Other revenue	3,377	3,821	3,947
Total revenue	42,097	39,912	30,319
Operating expenses:			
Cost of subscription revenue	10,365	8,072	6,820
Cost of other revenue	3,423	2,604	2,579
Total cost of revenue, exclusive of depreciation and amortization	13,788	10,676	9,399
Research and development	12,502	13,891	12,545
Sales and marketing	16,848	13,754	9,102
General and administrative	11,827	11,705	9,140
Depreciation and amortization	5,478	4,450	3,022
Amortization of intangibles	468	492	106
Total operating expenses	60,911	54,968	43,314
Operating loss	(18,814)	(15,056)	(12,995)
Non-operating income (expense):			
Interest and other borrowing costs	(2,319)	(600)	(1,092)
Change in fair value of warrant liability	167	3	(124)
Other non-operating income	39	10	2
Total non-operating income (expense)	(2,113)	(587)	(1,214)
Loss before income taxes	(20,927)	(15,643)	(14,209)
Income tax provision	(50)	(38)	(23)
Net loss	(20,977)	(15,681)	(14,232)
Dividends related to 7% Series B convertible preferred stock	(586)	(588)	(589)
Net loss available to common stockholders	$(21,563)	$(16,269)	$(14,821)
Per share of common stock:			
Basic net loss available to common stock holders	$(0.86)	$(0.70)	$(0.74)
Diluted net loss available to common stock holders	$(0.86)	$(0.70)	$(0.74)
Shares used to calculate basic net loss per share	25,209	23,264	19,923
Shares used to calculate diluted net loss per share	25,209	23,264	19,923
Stock-based compensation expense is included in individual line items above:			
Total cost of revenue	$371	$255	$181
Research and development	1,134	1,075	1,326
Sales and marketing	1,697	1,330	696
General and administrative	2,122	2,742	1,975

See accompanying notes to consolidated financial statements.

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MATTERSIGHT CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(In thousands)

	Year Ended December 31,		
	2016	2015	2014
Net loss	$(20,977)	$(15,681)	$(14,232)
Other comprehensive loss:			
Effect of currency translation	(20)	(1)	7
Comprehensive net loss	$(20,997)	$(15,682)	$(14,225)

See accompanying notes to consolidated financial statements.

MATTERSIGHT CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Year Ended December 31,		
	2016	2015	2014
Cash Flows from Operating Activities:			
Net loss	$(20,977)	$(15,681)	$(14,232)
Adjustments to reconcile net loss to net cash used in operating activities:			
Discount accretion and other debt-related costs	436	—	—
Depreciation and amortization	5,946	4,942	3,128
Stock-based compensation	5,324	5,402	4,178
Provision for uncollectible amounts	287	—	—
Change in fair value of warrant liability	(167)	(3)	124
Changes in assets and liabilities:			
Receivables	(3,932)	(1,403)	(1,076)
Prepaid expenses	71	(623)	(1,021)
Other current assets	(62)	(118)	192
Other long-term assets	(3,615)	1,028	936
Accounts payable	375	(29)	352
Accrued compensation and related costs	(459)	520	397
Unearned revenue	(2,307)	(2,416)	310
Other current liabilities	722	(1,675)	(73)
Other long-term liabilities	582	3,667	(149)
Total adjustments	3,201	9,292	7,298
Net cash used in operating activities	(17,776)	(6,389)	(6,934)
Cash Flows from Investing Activities:			
Capital expenditures	(3,714)	(4,917)	(766)
Investment in intangible assets	(349)	(171)	(251)
Net cash used in investing activities	(4,063)	(5,088)	(1,017)
Cash Flows from Financing Activities:			
Proceeds from term loan and other borrowings	28,880	—	—
Repayments of term loan and other borrowings	(6,945)	(750)	—
Proceeds from line of credit	16,246	15,000	7,000
Repayments of line of credit	(16,246)	(15,000)	(7,000)
Fees paid for issuance of term loan	(724)	—	—
Proceeds from issuance of common stock, net	—	15,942	11,138
Principal payments on capital lease obligations	(2,296)	(2,116)	(1,701)
Cash paid to satisfy tax withholding upon employee vesting	(440)	(874)	(797)
7% Series B convertible preferred stock dividend	(10)	—	—
Proceeds from exercise of stock options	236	241	13
Proceeds from employee stock purchase	289	212	152
Net cash provided by financing activities	18,990	12,655	8,805
Effect of exchange rate changes on cash and cash equivalents	(20)	(9)	(8)
(Decrease) increase in cash and cash equivalents	(2,869)	1,169	846
Cash and cash equivalents, beginning of period	15,407	14,238	13,392
Cash and cash equivalents, end of period	$12,538	$15,407	$14,238

Non-Cash Investing and Financing Transactions:			
Capital lease obligations incurred	$2,447	$2,737	$1,692
Capital equipment purchased on credit	2,447	2,737	1,692
Financing of intellectual property purchased, at fair value	—	1,958	—
Issuance of warrant, at fair value	924	—	380
Supplemental Disclosures of Cash Flow Information:			
Interest paid	$1,343	$314	$266

See accompanying notes to consolidated financial statements.

MATTERSIGHT CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(In thousands, except share data)

	Common Stock Issued		Additional Paid-in			Accumulated Other Compre-hensive	Total Stock-holders'
	Shares	Amount	Capital	Accumulated Deficit	Treasury Stock	Loss	Equity
Balance, December 31, 2013	20,465,984	$ 205	$228,038	$ (212,172)	$ (8,082)	$ (4,033)	$3,956
Proceeds from issuance of common stock, net	2,891,566	29	11,109	—	—	—	11,138
Issuance of common stock for option awards exercised	2,914	—	14	—	—	—	14
Issuance of common stock for warrants exercised	86,366	1	528	—	—	—	529
Issuance of common stock related to employee stock programs	643,706	5	189	—	—	—	194
Amortization/forfeitures of unearned compensation	(44,496)	—	3,988	—	—	—	3,988
Restricted stock vestings tax withholding	—	—	—	—	(797)	—	(797)
Series B convertible preferred stock conversions	937	—	5	—	—	—	5
Series B convertible preferred stock dividend	—	—	(589)	—	—	—	(589)
Other comprehensive gain	—	—	—	—	—	7	7
Net loss	—	—	—	(14,232)	—	—	(14,232)
Balance, December 31, 2014	24,046,977	$ 240	$243,282	$ (226,404)	$ (8,879)	$ (4,026)	$4,213
Proceeds from issuance of common stock, net	2,728,712	27	15,915	—	—	—	15,942
Issuance of common stock for option awards	41,750	—	282	—	—	—	282

exercised							
Issuance of common stock for warrants							
exercised	50,184	1	377	—	—	—	378
Issuance of common stock related to employee							
stock programs	819,632	8	263	—	—	—	271
Amortization/forfeitures of unearned							
compensation	(53,819)	—	5,178	—	—	—	5,178
Restricted stock vestings tax withholding	—	—	—	—	(874)	—	(874)
Reissuance of treasury shares	—	—	(514)	—	514	—	—
Series B convertible preferred stock conversions	3,417	—	17	—	—	—	17
Series B convertible preferred stock dividend	—	—	(588)	—	—	—	(588)
Other comprehensive (loss)	—	—	—	—	—	(1)	(1)
Net loss	—	—	—	(15,681)	—	—	(15,681)
Balance, December 31, 2015	27,636,853	$ 276	$ 264,212	$ (242,085)	$ (9,239)	$ (4,027)	$ 9,137
Issuance of common stock for option awards							
exercised	—	—	236	—	—	—	236
Issuance of common stock related to employee							
stock programs	88,282	—	383	—	—	—	383
Amortization/forfeitures of unearned							
compensation	(220,594)	(1)	5,159	—	—	—	5,158
Restricted stock vestings tax withholding	—	—	—	—	(440)	—	(440)
Reissuance of treasury shares	—	—	(5,224)	—	5,224	—	—
Series B convertible preferred stock conversions	6,820	—	34	—	—	—	34
Series B convertible preferred stock dividend	—	—	(586)	—	—	—	(586)
Other comprehensive (loss)	—	—	—	—	—	(20)	(20)
Net loss	—	—	—	(20,977)	—	—	(20,977)
Balance, December 31, 2016	27,511,361	$ 275	$ 264,214	$ (263,062)	$ (4,455)	$ (4,047)	$ (7,075)

See accompanying notes to consolidated financial statements.

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in millions, except share and per share data)

Note One — Description of Business

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

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

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

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

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MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note Two — Summary of Significant Accounting Policies

Consolidation

The consolidated financial statements include the accounts of Mattersight and all of its subsidiaries. All significant intercompany transactions have been eliminated.

Use of Estimates

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those amounts.

Basis of Presentation

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

In August 2014, the Financial Accounting Standards Board (FASB) issued ASU No. 2014-15: Presentation of Financial Statements - Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern. The standard provides guidance on determining when and how to disclose going concern uncertainties in the financial statements. Management will be required to perform interim and annual assessments of the Company’s ability to continue as a going concern within one year of the date financial statements are issued. ASU 2014-15 is effective for annual and interim periods ending after December 15, 2016, with early adoption permitted. The Company adopted this standard during 2016 with no significant impact on the Company financial statement disclosure. See Note Twenty—Subsequent Event.

Revenue Recognition

Subscription Revenue

Subscription revenue consists of revenue derived from Mattersight’s Behavioral Analytics service offerings, including predictive behavioral routing, performance management, quality assurance, predictive analytics, and marketing managed services revenue derived from the performance of services on a continual basis.

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

Other Revenue

Other revenue consists of deployment revenue, professional services revenue, and reimbursed expenses revenue.

Deployment revenue consists of planning, deployment, and training fees derived from Behavioral Analytics contracts. These fees, which are considered to be installation fees related to Behavioral Analytics subscription contracts, are deferred until the installation is complete and are then recognized over the applicable subscription or pilot period. Installation costs incurred are deferred up to an amount not to exceed the amount of deferred installation revenue and additional amounts that are recoverable based on the contractual arrangement. These costs are included in prepaid expenses and other long-term assets. Such costs are amortized over the subscription period. Costs in excess of the foregoing revenue amount are expensed in the period incurred.

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

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

Reimbursed expenses revenue includes billable costs related to travel and other out-of-pocket expenses incurred while performing services for the Company's clients. An equivalent amount of reimbursable expenses is included in total cost of other revenue.

Total Cost of Revenue, Exclusive of Depreciation and Amortization

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

If the Company's estimates indicate that a contract loss will occur, then a loss provision is recorded in the period in which the loss first becomes probable and can be reasonably estimated.

Research and Development

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

Sales and Marketing

Sales and marketing expenses consist primarily of salaries, incentive compensation, commissions, and employee benefits for business development, account management, and marketing.

General and Administrative

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

Loss Per Common Share

The per common share basic net loss available to holders of the Company's Common Stock, par value $0.01 per share (Common Stock), has been computed by dividing the net loss available to holders of Common Stock for each period presented by the weighted average shares outstanding. The per common share diluted loss available to holders of Common Stock has been computed by dividing the net loss available to holders of Common Stock by the weighted average shares outstanding plus the dilutive effect of Common Stock equivalents, which is primarily related to our 7% Series B Convertible Preferred Stock (Series B Stock), using the treasury stock method. In periods in which there was

a loss, the dilutive effect of Common Stock equivalents is not included in the diluted loss per share calculation as it was antidilutive.

Fair Value Measurements

Fair value is an exit price and establishes a three-tier valuation hierarchy for ranking the quality and reliability of the information used to determine fair values. The first tier, Level 1, uses quoted market prices in active markets for identical assets or liabilities. Level 2 uses inputs, other than quoted market prices for identical assets or liabilities in active markets, which are observable either directly or indirectly. Level 3 uses unobservable inputs in which there are little or no market data, and requires the entity to develop its own assumptions. A financial asset or liability's classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Cash and Cash Equivalents

The Company considers all highly liquid investments readily convertible into known amounts of cash (with original purchased maturities of three months or less) to be cash equivalents.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to a concentration of credit risk consist of cash and cash equivalents, which includes foreign bank accounts, and receivables. Cash and cash equivalents consist of money market funds and deposits with high credit quality financial institutions. At times, such deposits may be in excess of the Federal Deposit Insurance Corporation insurance limit. Accounts in the United States are insured by the Federal Deposit Insurance Corporation up to $250,000. At December 31, 2016, the Company had non-interest-bearing cash and interest-bearing money market balances in excess of federally insured limits by $11.8 million. The Company's receivables are derived from billings to clients located primarily in the United States and are denominated in U.S. dollars. For 2016, there were three clients that accounted for 10% or more of total revenue: United HealthCare Services, Inc.; CVS Caremark Corporation, and Progressive Casualty Insurance Company; which accounted for 33%, 15%, and 11% of total revenue, respectively. For 2015, there were three clients that accounted for 10% or more of total revenue: United HealthCare Services, Inc.; Progressive Casualty Insurance Company; and CVS Caremark Corporation, which accounted for 31%, 15%, and 13% of total revenue, respectively. For 2014, there were three clients that accounted for 10% or more of total revenue: United HealthCare Services, Inc.; Progressive Casualty Insurance Company; and Health Care Service Corporation; which accounted for 25%, 20%, and 11% of total revenue, respectively. As of December 31, 2016, two clients, United HealthCare Services, Inc. and CVS Caremark Corporation, accounted for 41% and 27% of total gross accounts receivable, respectively. As of December 31, 2015, two clients, United HealthCare Services, Inc. and CVS Pharmacy, Inc. accounted for 46% and 19% of total gross accounts receivable, respectively.

Equipment and Leasehold Improvements

Computers, software, furniture, and equipment are carried at cost and depreciated on a straight-line basis over their estimated useful lives. Leasehold improvements are amortized over the lesser of the useful life or the lease term. The useful life for computers and software is between one and three years. For enterprise software applications where a longer useful life is deemed appropriate, five years is used. For furniture and equipment, a useful life of five years is used. Maintenance and repair costs are expensed as incurred. The cost and related accumulated depreciation of assets sold or disposed of are eliminated from the respective accounts and the resulting gain or loss is included in the statements of operations. The carrying value of equipment and leasehold improvements is only reviewed if a triggering event occurs to assess recoverability based on future undiscounted cash flows. An impairment loss, if any, would be measured as the excess of the carrying value over the fair value.

The Company accounts for software developed for internal use in accordance with the guidance provided under ASC Topic 350, Intangibles – Goodwill and Other, which addresses accounting for the costs of computer software developed or obtained for internal use. As such, costs incurred that relate to the planning and post-implementation phases of development are expensed. Costs incurred during the application development stage are capitalized and amortized over the asset's estimated useful life, which is generally three to five years.

The Company leases certain equipment using both capital leases and operating leases. Assets leased under capital leases are recorded at the lesser of the amount financed and present value of future lease payments and depreciated on a straight line basis. All capital leases are for terms of twenty-four, thirty, or thirty-six months.

Goodwill

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

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

In 2016, after completing our annual qualitative review, we concluded that it was not more likely than not that the carrying value of our reporting unit exceeded its fair value. Accordingly, we concluded that further quantitative analysis and testing was not required, and no goodwill impairment charge was required.

Intangible Assets

Intangible assets subject to amortization are assessed for impairment at least annually or when indicated by a change in economic or operational circumstances. The impairment assessment of these assets requires management to first compare the book value of the amortizing asset to undiscounted cash flows only if there are indicators of a change in circumstances. If the book value exceeds the undiscounted cash flows, management is then required to estimate the fair value of the assets and record an impairment loss for the excess of the carrying value over the fair value and annually challenge the useful lives.

Income Taxes

The Company uses an asset and liability approach for financial accounting and reporting of income taxes. Deferred income taxes are provided when tax laws and financial accounting standards differ with respect to the amount of income for the year, the basis of assets and liabilities and for tax loss carryforwards.

The Company has recorded income tax valuation allowances on its net deferred tax assets to account for the unpredictability surrounding the timing of realization of its U.S. and non-U.S. net deferred tax assets due to continuing operating losses. The valuation allowances may be reversed at a point in time when management determines realization of these tax assets has become more likely than not, based on a return to or achieving predictable levels of profitability.

The Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. Significant judgment is used to determine the likelihood of the benefit.

Unearned Revenue

Unearned revenue consists of billings or payments received in advance of revenue recognition for Behavioral Analytics contracts. Unearned revenue is recognized as revenue when the applicable recognition criteria are met.

Stockholders’ Equity

Stockholders’ equity includes Common Stock issued, additional paid-in capital, accumulated deficit, treasury stock, and accumulated other comprehensive loss. The 1.6 million shares of Series B Stock outstanding as of December 31, 2016 and 2015 are not classified as permanent equity or a liability in the accompanying balance sheets. These shares of Series B Stock are conditionally redeemable and do not meet the definition of a mandatorily redeemable financial instrument. The holders of Series B Stock have the ability to initiate a redemption upon the occurrence of certain

events that are considered outside the Company's control.

Foreign Currency Translation

The functional currencies for the Company's foreign subsidiaries are their local currencies. All assets and liabilities of foreign subsidiaries are translated to U.S. dollars at end of period exchange rates. The resulting translation adjustments are recorded as a component of stockholders' equity and comprehensive loss. Income and expense items are translated at average exchange rates prevailing during the period.

Stock-Based Compensation

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

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Stock Warrants

In accordance with ASC 480-10, Distinguishing Liabilities from Equity, the Company classified certain warrants to purchase Common Stock as liabilities that do not meet the requirements for classification as equity. Such liabilities are initially recorded at fair value with subsequent changes in fair value recorded as a component of gain or loss on warrant liability on the consolidated statements of operations in each reporting period. Fair value of the warrants was measured using a Black-Scholes model. See Note Seventeen—Fair Value Measurements.

Segments

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

Recent Accounting Pronouncements

In January 2017, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2017-04, Intangibles—Goodwill and Other, simplifying the test for goodwill impairment. This ASU simplifies how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Step 2 measures a goodwill impairment loss by comparing the implied fair value of a reporting unit's goodwill with the carrying amount of that goodwill. Goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value. This ASU is effective for reporting periods beginning after December 15, 2019 and interim periods within those annual periods. The company is currently evaluating the impact of this update on the company's consolidated financial statements.

In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows: Restricted Cash, to clarify how restricted cash should be presented in the cash flow statement. This update is effective for reporting periods beginning after December 15, 2017 and interim periods within those annual periods. Upon adoption of this ASU restricted cash will roll into cash and cash equivalents on the cash flow statement.

In October 2016, the FASB issued ASU No. 2016-16, Income Taxes: Intra-Entity Transfers of Assets Other Than Inventory, which requires an entity to recognize the income tax consequences of intra-entity transfers, other than inventory, when the transfer occurs. Under current guidance in U.S. GAAP, in the case of depreciable or amortizable assets, the income tax consequences are deferred at the time of the intra-entity transfer and recognized as the assets are depreciated or amortized. This ASU is effective for reporting periods beginning after December 15, 2017 and interim periods within those annual periods, and requires modified retrospective transition with a cumulative catch-up adjustment to opening retained earnings in the period of adoption. The company is currently evaluating the impact of this update on the company's consolidated financial statements.

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

securitization transactions, and (viii) separately identifiable cash flows and application of the predominance principle. The amendments in this update are effective for public business entities for periods beginning after December 15, 2017. The company is currently evaluating the impact of this update on its consolidated financial statements.

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

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

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

update is effective for annual periods beginning after December 15, 2016. The company is currently evaluating the impact of this update on its consolidated financial statements.

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

In November 2015, the FASB issued ASU No. 2015-17, Income Taxes (Topic 740). This update simplifies the presentation of deferred income taxes and requires that deferred income tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The update is effective for reporting periods beginning after December 15, 2016 and interim periods within those annual periods. The adoption of ASU 2015-17 is not expected to have a material impact on the company’s consolidated financial statements.

In May 2014, FASB issued ASU 2014-09: Revenue from Contracts with Customers (Topic 606). This update sets forth a new five-step revenue recognition model that replaces the prior revenue recognition guidance in its entirety and is intended to eliminate numerous industry-specific pieces of revenue recognition guidance that have historically existed. The underlying principle of the new standard is that an organization will recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects what it expects in exchange for the goods or services. ASU 2014-09 provides alternative methods of initial adoption and is effective for annual periods beginning after December 15, 2017 and interim periods within those annual periods. Early adoption is not permitted prior to December 15, 2016. Based on its preliminary assessment, the company generally does not expect a significant change in revenue recognition when ASU 2014-09 is adopted. The Company will be putting additional processes and controls in place to enable compliance with ASU 2014-09’s disclosure requirements.

Note Three — Receivables

Receivables consist of the following:

	December 31, 2016	December 31, 2015
Amounts billed to clients	$ 8.8	$ 4.2
Unbilled revenue	—	0.7
	8.8	4.9

Allowances for doubtful accounts	0.3	—
Receivables, net	$ 8.5	$ 4.9

Amounts billed to clients represent fees and reimbursable project-related expenses. Unbilled revenue represents fees, project-related expenses, materials, and subcontractor costs performed in advance of billings in accordance with contract terms. Unbilled revenue at December 31, 2016 and December 31, 2015 consists of amounts due from clients and is anticipated to be collected within normal terms. The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its clients to make required payments and clients indicating their intention to dispute their obligation to pay for contractual services provided by us. If the financial condition of the Company’s clients were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Note Four — Current Prepaid Expenses

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

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Current prepaid expenses consisted of the following:

	December 31, 2016	December 31, 2015
Deferred costs	$ 1.7	$ 1.6
Prepaid commissions	1.2	1.4
Other	1.5	1.6
Total	$ 4.4	$ 4.6

Note Five — Equipment and Leasehold Improvements

Equipment and leasehold improvements consist of the following:

	December 31, 2016	December 31, 2015
Computers and software	$ 24.3	$ 19.8
Furniture and equipment	0.7	0.3
Leasehold improvements	4.3	3.2
Equipment and leasehold improvements, gross	29.3	23.3
Accumulated depreciation and amortization	(19.7)	(14.8)
Equipment and leasehold improvements, net	$ 9.6	$ 8.5

Depreciation and amortization expense was $5.5 million, $4.4 million, and $3.0 million, for 2016, 2015, and 2014, respectively. Assets acquired under capital leases were $2.4 million, $2.7 million, and $1.7 million, in 2016, 2015, and 2014, respectively. Depreciation and amortization expense on capital lease assets was $2.0 million, $2.2 million, and $1.7 million, in 2016, 2015, and 2014, respectively.

The carrying value of equipment and leasehold improvements is only reviewed if a triggering event occurs to assess recoverability based on future undiscounted cash flows. An impairment loss, if any, would be measured as the excess of the carrying value over the fair value. There was a triggering event as of December 31, 2016 and December 31, 2015; however no impairment was required to be recognized.

Note Six — Intangible Assets

Intangible assets reflect costs related to patent and trademark applications, marketing managed services customer relationships and the purchase of certain intellectual property rights. The costs related to patent and trademark applications and the purchase of certain intellectual property are amortized over 120 months. The other intangible assets are fully amortized. Currently, amortization expense of intangible assets is expected to be $0.4 million annually.

	December 31, 2016	December 31, 2015
Patents and trademarks	$ 3.7	$ 3.4
Intellectual property	3.3	3.3
Gross intangible assets	7.0	6.7
Accumulated amortization of intangible assets	(3.8)	(3.4)
Total	$ 3.2	$ 3.3

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note Seven — Other Long-Term Assets

Other long-term assets includes the long-term portion of deferred costs, prepaid commissions related to Behavioral Analytics, and restricted cash. Restricted cash represents cash used to collateralize certain letters of credit issued to support the company's equipment leasing activities. These costs are recognized over the terms of the respective contracts, generally one to three years. Costs included in long-term assets will be recognized over the remaining term of the contracts beyond the first twelve months. Other long-term assets consisted of the following:

	December 31, 2016	December 31, 2015
Restricted cash	$ 4.2	$ —
Deferred costs	0.6	0.9
Other prepaid expenses	0.6	0.3
Prepaid commissions	0.5	1.2
Other	0.1	0.1
Total	$ 6.0	$ 2.5

Note Eight — Employee Benefit Plans

The Company's U.S. employees are eligible to participate in the Mattersight Corporation 401(k) Plan (the Plan) on the first day of the month coinciding with or following their date of hire. The Plan allows employees to contribute up to 30% of their eligible compensation and up to 100% of their bonus compensation, subject to IRS statutory limits. For 2016 and 2015, the employer match contribution was $0.5 million and $0.4 million, respectively. For 2014, Mattersight suspended the employer matching contributions for U.S. plans.

Note Nine — Stock-Based Compensation

The Company has two stock-based compensation plans: the Mattersight Corporation 1999 Stock Incentive Plan (the 1999 Plan) and the Mattersight Corporation Employee Stock Purchase Plan (the ESPP).

Under the 1999 Plan, awards of restricted stock, salary replacement, commissions, stock options, and stock appreciation rights may be granted to directors, officers, employees, consultants, independent contractors, and agents of the Company and its subsidiaries. Awards granted under the 1999 Plan are made at the discretion of the Compensation Committee of the Company's Board of Directors (the Compensation Committee). If shares or options

awarded under the 1999 Plan are not issued due to cancellation of unvested or unexercised options or shares, then those shares or options again become available for issuance under the 1999 Plan. Under the 1999 Plan, on the first day of each year, the aggregate number of shares available for issuance under the 1999 Plan is automatically increased by an amount equal to 5% of the total number of shares of Common Stock that are outstanding. At the 2008 Annual Meeting of Stockholders, stockholders approved the amendment and restatement of the 1999 Plan to increase the number of shares available for issuance under the 1999 Plan by 1,500,000.

Stock-based compensation expense was $5.3 million, $5.4 million, and $4.2 million, for 2016, 2015, and 2014, respectively. The Company recognizes stock compensation expense on a straight-line basis over the vesting period. The Company does not recognize the windfall tax benefit related to the excess tax deduction because the Company currently does not anticipate realizing the tax savings associated with this deduction. See Note Fifteen—Income Taxes.

As of December 31, 2016, there were a total of 2,471,347 shares of Common Stock available for future grants under the 1999 Plan and from treasury stock. The Company’s Common Stock is traded on the NASDAQ Global Market under the symbol MATR.

Restricted Stock

Restricted stock awards are shares of Common Stock granted to an individual that do not immediately vest but rather vest over a period of time. During the vesting period, the holder of granted restricted stock receives all of the benefits of ownership (right to dividends, voting rights, etc.), other than the right to sell or otherwise transfer any interest in the stock. In addition to the Annual Grant (as defined under the section titled Stock Options below), each non-employee director receives 10,000 shares of restricted stock annually, the day after the Company’s annual stockholders’ meeting, which vest 25% at the end of the month in which awarded and the remaining balance vests over the following three quarters.

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Restricted stock award activity was as follows for 2014, 2015, and 2016:

	Shares	Weighted Average Price
Nonvested balance at December 31, 2013	450,223	$ 6.25
Granted	609,355	$ 5.70
Vested	(458,888)	$ 6.12
Forfeited	(44,496)	$ 6.13
Nonvested balance at December 31, 2014	556,194	$ 5.76
Granted	825,120	$ 6.78
Vested	(493,270)	$ 6.18
Forfeited	(53,819)	$ 6.15
Nonvested balance at December 31, 2015	834,225	$ 6.49
Granted	950,340	$ 3.89
Vested	(380,218)	$ 5.34
Forfeited	(220,594)	$ 5.98
Nonvested balance at December 31, 2016	1,183,753	$ 4.87

	2016	2015	2014
Total fair value of restricted stock awards vested	$1.6	$3.3	$2.6
Compensation expense related to restricted stock awards	$4.0	$2.3	$1.7

As of December 31, 2016, there remains $2.9 million of unrecognized compensation expense related to restricted stock awards. These costs are expected to be recognized over a weighted average period of 1.6 years. The Company estimated the forfeiture rate at 3% for 2016, 2015, and 2014.

Stock Options

Stock option awards may be in the form of incentive or non-qualified options. Stock options are granted with an exercise price per share equal to the fair market value of a share of the common stock on the date of grant, and have a maximum term of 10 years. The stock option terms are set by the Compensation Committee and generally become exercisable over a period of four years. The vesting can begin in equal monthly or quarterly increments over the vesting period.

Each non-employee director, upon commencing service, receives a non-qualified stock option to purchase 50,000 shares of Common Stock that vests ratably over a period of 48 months. Additionally, each non-employee director receives a non-qualified stock option to purchase 10,000 shares of Common Stock, granted annually the day after the Company’s annual stockholders’ meeting (the Annual Grant). Stock options granted to non-employee directors have an

exercise price per share equal to the fair market value of a share of Common Stock on the grant date, and are exercisable for up to 10 years.

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Option activity was as follows for the years presented:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Weighted Average Fair Value of Option Grants
Outstanding as of December 31, 2013	2,014,238	$ 7.98	7.0	
Exercisable as of December 31, 2013	1,204,786	$ 9.66	5.8	
Granted	654,000	$ 5.63		$ 3.33
Exercised	(2,914)	$ 5.15		
Forfeited	(28,728)	$ 5.85		
Outstanding as of December 31, 2014	2,636,596	$ 7.42	6.8	
Exercisable as of December 31, 2014	1,582,165	$ 8.70	5.6	
Outstanding intrinsic value at December 31, 2014	$2.1			
Exercisable intrinsic value at December 31, 2014	$1.1			
Granted	222,625	$ 6.57		$ 3.55
Exercised	(59,638)	$ 4.76		
Forfeited	(192,166)	$ 7.47		
Outstanding as of December 31, 2015	2,607,417	$ 7.41	6.0	
Exercisable as of December 31, 2015	1,967,825	$ 7.97	5.2	
Outstanding intrinsic value at December 31, 2015	$2.4			
Exercisable intrinsic value at December 31, 2015	$1.8			
Granted	115,000	$ 3.82		$ 1.85
Exercised	(56,250)	$ 4.20		
Forfeited	(74,026)	$ 6.13		
Outstanding as of December 31, 2016	2,592,141	$ 7.36	4.9	
Exercisable as of December 31, 2016	2,282,476	$ 7.61	4.5	
Outstanding intrinsic value at December 31, 2016	$—			
Exercisable intrinsic value at December 31, 2016	$—			

	2016	2015	2014
Compensation expense related to option awards	$1.1	$1.7	$1.4

	2016	2015	2014
Total fair value of stock options vested	$1.1	$1.7	$1.3

Intrinsic value of stock options exercised	—	0.1	—
Proceeds received from option exercises	0.2	0.3	—

As of December 31, 2016, there remained $0.9 million of unrecognized compensation expense related to stock options. These costs are expected to be recognized over a weighted average period of 1.4 years. The Company forfeiture rate was not applied as the impact was negligible.

The following table summarizes the stock options granted during 2016, 2015, and 2014 by range of exercise price:

	2016	2015	2014
Options granted	115,000	222,625	654,000
Range of exercise price	$3.57 - $4.40	$6.13 - $6.90	$4.88 - $6.38

The vesting schedule for options granted is one of the following: (1) vesting 6.25% quarterly, with the balance vesting ratably over the following 15 quarters, (2) vesting 25% at the end of the month in which awarded and the remaining balance vesting over the following 12 quarters (3) vesting 25% at the end of the month in which awarded and the remaining balance vesting over the following 3 quarters.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The fair value for options granted during 2016, 2015, and 2014 was estimated on the date of grant using a Black Scholes option-pricing model. The Company used the following weighted average assumptions:

	2016	2015	2014
Risk-free interest rates	0.81 %	1.03 %	1.4 %
Expected dividend yield	—	—	—
Expected volatility	54 %	58 %	65 %
Expected lives	5.5 years	6.0 years	6.0 years

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

Employee Stock Purchase Plan

The ESPP is intended to qualify as an employee stock purchase plan under section 423 of the Internal Revenue Code. We adopted the ESPP in 1999 and amended and restated the ESPP in May 2007 and February 2016. Under the ESPP, eligible employees are permitted to purchase shares of Common Stock at below-market prices. The purchase period opens on the first day and ends on the last business day of each calendar quarter. As of December 31, 2016, there remains 85,782 shares available for issuance under ESPP. The shares of Common Stock issued in respect of employee purchases under the ESPP during 2016, 2015, and 2014, were as follows:

	2016	2015	2014
Shares of common stock issued	88,282	41,026	34,351
Expense related to ESPP (in thousands)	$95	$61	$44

The fair value for ESPP purchases during 2016, 2015, and 2014, was estimated using a Black Scholes model. The Company used the following weighted average assumptions:

	2016	2015	2014
Risk-free interest rates	0.25 %	0.01 %	0.04 %
Expected dividend yield	—	—	—
Expected volatility	48 %	37 %	42 %
Expected lives	0.25 years	0.25 years	0.25 years

Note Ten — Other Current Liabilities

	December 31, 2016	December 31, 2015
Accrued vendor payable	$ 1.9	$ 0.7
Warrant liability	0.8	—
Deferred rent liability	0.4	0.3
Other	0.3	0.8
Total	$ 3.4	$ 1.8

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

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note Eleven — Leases

Capital Leases

Assets under capital leases consist of computer hardware and related equipment. The gross amount of assets recorded under capital leases was $6.5 million and $6.0 million at December 31, 2016 and December 31, 2015, respectively. Depreciation expense related to assets under capital leases is included in depreciation and amortization expense on the consolidated statements of operations.

The following is a schedule, by year, of future minimum lease payments under capital leases, together with the present value of the net minimum lease payments as of December 31, 2016:

(In millions)	
Year	Amount
2017	$ 2.0
2018	1.5
2019	0.4
2020	—
Total minimum lease payments	$ 3.9
Less: estimated executory costs	—
Net minimum lease payments	$ 3.9
Less: amount representing interest	(0.3)
Present value of minimum lease payments	$ 3.6

Capital leases included in equipment and leasehold improvements (see Note Five—Equipment and Leasehold Improvements):

	December 31, 2016	December 31, 2015
Computers and software	$ 6.5	$ 6.0
Accumulated depreciation and amortization	(2.9)	(2.6)
Computers and software, net	$ 3.6	$ 3.4

Operating Leases

The Company leases various office facilities under leases expiring at various dates through August 31, 2023. Additionally, the Company leases various property and office equipment under operating leases, generally under three year terms, expiring at various dates. Certain lease agreements contain escalating rent clauses, which require higher rent payments in future years. The Company expenses rent on a straight-line basis over the term of the lease, including any rent-free periods. In addition, the Company received certain leasehold improvement incentives, and recorded these incentives as deferred rent, which is amortized as a reduction of rent expense over the life of the lease. Net deferred rent on the consolidated balance sheet as of December 31, 2016, 2015, and 2014 was $2.6 million, $2.0 million, and $0.1 million, respectively. Rental expense for all operating leases approximated $1.3 million, $1.7 million, and $2.0 million, for 2016, 2015, and 2014, respectively.

In 2016, the Company entered into an operating lease to relocate its Austin facility. The initial lease term, which became effective on April 1, 2016, terminates on August 31, 2023. In 2015, the Company entered into an operating lease to relocate its corporate headquarters to Chicago, Illinois. The initial lease term, which became effective on July 1, 2015, terminates on July 31, 2022. The leases include one five-year renewal option.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Future minimum rental commitments under non-cancelable operating leases with terms in excess of one year are as follows: (in millions)

Year	Amount
2017	$ 1.1
2018	0.7
2019	0.6
2020	0.5
2021	0.5
Thereafter	0.5
Total minimum payments required	$ 3.9

Note Twelve — Debt

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

The annual interest rate is equal to the greater of (i) 9.75% plus the prime rate minus 3.50% or (ii) 9.75%. Additionally, the principal balance will bear compounding payment-in-kind interest at an annual rate of 2.15%. Monthly payments are interest only until December 1, 2017, subject to extension until March 1, 2018 or June 1, 2018 depending on whether certain financial milestones are met. After the interest-only period, principal and interest will be due in equal monthly payments. The company may prepay all, but not a portion, of the loan. A prepayment charge of 3.0%, 2.0% or 1.0% of the outstanding balance would be due in year one, in year two, or after year two, respectively.

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

Prior to entering into the secured loan agreement with Hercules Capital, Inc., the company was party to a credit facility and term loan with Silicon Valley Bank. The credit facility and term loan were terminated on August 1, 2016. The company used a portion of the proceeds from the Hercules Capital, Inc. secured loan agreement to repay its $6.0 million term loan with Silicon Valley Bank and to pay borrowing-related fees and expenses. The company expects to

use the remaining proceeds and any future borrowings under the Hercules secured loan agreement for general corporate purposes.

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

Debt consisted of the following at December 31, 2016:

(In millions)	Amount
Hercules Capital, Inc. loan due February 1, 2020, effective rate of 14.50%	$ 22.5
Furniture loan due May 2021, effective rate of 9.10%	0.1
Furniture loan due May 2021, effective rate of 9.55%	0.1
Furniture loan due July 2019, effective rate of 13.98%	0.1
Total debt[1]	$ 22.8

[1] The current portion of the principal due was $0.7 million at December 31, 2016.
The balance of long-term debt in the consolidated balance sheet includes $0.6 million of unamortized debt costs and $0.7 million of unaccreted debt discount.

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Debt maturities were as follows as of December 31, 2016:

(In millions)	
Year	Amount
2017	$ 0.7
2018	8.3
2019	9.2
2020	4.5
2021	0.1

Letters of Credit

Restricted cash represents cash used to collateralize certain letters of credit issued to support the company's equipment leasing activities and building lease spaces. The letters of credit in the amount of $4.2 million are expected to expire 2017—2023. The restrictions on cash are recognized over the terms of the respective contracts, generally one to three years for equipment leases and seven years for building leases.

Note Thirteen — Other Long-Term Liabilities

	December 31, 2016	December 31, 2015
7% Series B convertible preferred stock dividend payable	$ 2.6	$ 2.1
Deferred rent liability	2.2	1.7
Intellectual property purchase liability	0.8	1.6
Deferred tax liability	0.3	0.3
Total	$ 5.9	$ 5.7

Note Fourteen — Capital Stock and Series B Stock

Under the terms of its Certificate of Incorporation, as amended, the Company's authorized capital stock consists of (i) 50,000,000 shares of Common Stock, and (ii) 40,000,000 shares of preferred stock (Preferred Stock). Under the terms of the Certificate of Designations of 7% Series B Convertible Preferred Stock, the Company designated 5,000,000 shares of the 40,000,000 shares of Preferred Stock as its Series B Stock. 1,637,948 and 1,644,768 shares of Series B Stock were issued and outstanding as of December 31, 2016 and December 31, 2015, respectively.

On July 22, 2015, the Company signed a definitive Common Stock Purchase Agreement (the 2015 Purchase Agreement) to raise approximately $16.2 million in gross proceeds in a registered direct offering. Under the terms of the 2015 Purchase Agreement, the Company sold 2,728,712 shares of Common Stock (the Shares). Of the aggregate 2,728,712 Shares, 2,563,238 were sold to certain investors at a price of $5.93 per share and 165,474 were sold to certain officers and directors (including certain of their affiliates) at a price of $6.11 per share. The Shares represented approximately 12% of the issued and outstanding shares of Common Stock immediately prior to the execution of the 2015 Purchase Agreement. The offering closed on July 23, 2015. The aggregate proceeds that the Company received from the offering, net of fees, were approximately $15.9 million. Proceeds from the offering are being used for general corporate and working capital purposes. Craig-Hallum Capital Group LLC, which acted as the Company's financial advisor for the offering, received a fee of $0.2 million. The Shares were sold pursuant to a prospectus supplement dated as of July 22, 2015, in connection with a takedown from the Company's effective shelf registration statement on Form S-3 (File No. 333-202744), which was filed with the SEC on March 13, 2015 and declared effective by the SEC on April 8, 2015.

On July 23, 2014, the Company entered into a Common Stock Purchase Agreement (the 2014 Purchase Agreement) with certain accredited investors party thereto (the 2014 Purchasers). Under the terms of the 2014 Purchase Agreement, the Company sold, and the 2014 Purchasers purchased from the Company, 2,891,566 shares of Common Stock (the 2014 Shares), at a price of $4.15 per share, to certain institutional investors. The 2014 Shares represented 15% of the issued and outstanding shares of Common Stock immediately prior to the execution of the 2014 Purchase Agreement. The offering closed on July 29, 2014. The aggregate gross proceeds, net of fees, that the Company received from the offering were approximately $11.1 million. Craig-Hallum Capital Group LLC, which acted as the sole placement agent for the offering, received a commission equal to 7% of the aggregate purchase price (excluding certain accounts), for an aggregate commission of $0.8 million, and was reimbursed for its out-of-pocket expenses.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The Series B Stock accrues dividends at a rate of 7% per annum, is entitled to a preference upon liquidation, and is convertible on a one-for-one basis into shares of Common Stock, subject to adjustment for stock splits, stock dividends, and similar actions. The Series B Stock generally votes on a one-for-one basis with the Common Stock, subject to adjustment for certain actions and specified matters as to which the Series B Stock is entitled to a separate class vote.

Note Fifteen — Income Taxes

Loss before income taxes consisted of the following:

	2016	2015	2014
United States	$(20.9)	$(15.5)	$(14.2)
Foreign	—	(0.1)	—
Total	$(20.9)	$(15.6)	$(14.2)

The income tax (provision) benefit consists of the following:

	2016	2015	2014
Current:			
Federal	$(0.1)	$ —	$ —
State	—	—	—
Foreign	—	—	—
Total current	(0.1)	—	—
Deferred:			
Federal	—	—	—
State	—	—	—
Foreign	—	—	—
Total deferred	—	—	—
Income tax (provision) benefit	$(0.1)	$ —	$ —

Total income tax benefit differed from the amount computed by applying the federal statutory income tax rate due to the following:

	2016	2015	2014
Federal tax benefit, at statutory rate	$7.2	$5.5	$5.0
State tax benefit, net of federal benefit	0.6	0.4	0.4
Nondeductible expenses	(0.3)	0.1	(0.2)
Other	0.1	(1.1)	(0.3)
Valuation allowance	(7.7)	(4.9)	(4.9)
Income tax (provision) benefit	$(0.1)	$—	$—

The Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. Significant judgment is used to determine the likelihood of the benefit.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

A reconciliation of the gross amounts of unrecognized tax benefits at the beginning and end of the year are as follows:

	2016	2015	2014
Balance at beginning of year	$12.7	$12.7	$12.6
Additions based on tax positions related to the current year	—	—	—
Additions for tax positions of prior years	—	—	0.1
Reductions for tax positions of prior years	—	—	—
Reductions for tax positions as a result of lapse of statute	—	—	—
Settlements	—	—	—
Balance at end of year	$12.7	$12.7	$12.7

Due to the Company's net operating loss carryforward position, these unrecognized tax benefits will not impact the Company's effective tax rate, if recognized. Any change in the amount of unrecognized tax benefits within the next twelve months is not expected to result in a significant impact on the results of operations or the financial position of the Company.

Due to the Company's net operating loss carryforward position, accrued interest and penalties associated with uncertain tax positions as of December 31, 2016 are not material. Interest and penalties associated with uncertain tax positions are recorded as part of income tax expense.

The statutes of limitation for the Company's income tax returns after 2001 effectively remain open for examination by the IRS because the net operating loss carryforward from those years can be examined by the IRS for a period of three years after filing the tax return for the year the loss is used.

Foreign and U.S. state jurisdictions have statutes of limitations generally ranging from three to five years. The state impact of any federal changes remains subject to examination by various states for a period of up to one year after formal notification to the states. The Company and its subsidiaries may have various state and foreign income tax returns for immaterial jurisdictions in the process of examination throughout the reporting period.

Deferred tax assets and liabilities comprised the following:

	December 31, 2016	December 31, 2015
Deferred tax assets:		
Net operating loss carryforwards	$ 75.2	$ 70.8
Other accruals	8.8	5.6
Depreciation and amortization, including goodwill	0.8	0.4
Tax credit carryforward	0.5	0.5

Valuation allowance	(83.8)	(75.8)
Total deferred tax assets	1.5	1.5
Deferred tax liabilities:		
Prepaid expenses	(1.7)	(1.7)
Total deferred tax liabilities	(1.7)	(1.7)
Net deferred tax liability	$ (0.2)	$ (0.2)

Deferred income taxes are not provided on certain undistributed earnings of foreign subsidiaries that are expected to be permanently reinvested in those companies. These earnings aggregated to an immaterial amount at each of December 31, 2016 and December 31, 2015.

During 2002, the Company established a valuation allowance related to deferred tax assets for the U.S. This was in addition to the valuation allowance established in 2001 for non-U.S. deferred tax assets. The Company continues to provide a valuation allowance on significantly all domestic and foreign deferred tax assets as the Company has determined that it is more likely than not that the deferred tax assets in these jurisdictions will not be realized. As of December 31, 2016, net deferred tax assets of $83.8 million were fully offset by a valuation allowance. The Company’s U.S. federal net operating losses (NOLs) of $240.8 million and U.S. State NOLs of $127.7 million will expire beginning in 2022 and 2017, respectively. The Company’s non-U.S. NOLs of $0.6 million are subject to

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

various expiration dates beginning in 2029. The Company also carries $0.5 million in Research and Development credit carryforwards that will expire beginning in 2020.

The Company's ability to utilize its NOLs could become subject to significant limitations under Section 382 of the Internal Revenue Code if the Company were to undergo an ownership change. An ownership change would occur if the stockholders who own or have owned, directly or indirectly, 5% or more of the Company's Common Stock or are otherwise treated as 5% stockholders under Section 382 and the regulations promulgated thereunder, increase their aggregate percentage ownership of the Company's stock by more than 50 percentage points over the lowest percentage of the stock owned by these stockholders at any time during the testing period, which is generally the three-year period preceding the potential ownership change. In the event of an ownership change, Section 382 imposes an annual limitation on the amount of taxable income a corporation may offset with NOL carryforwards. Any unused annual limitation may be carried over to later years until the applicable expiration date for the respective NOL carryforwards. The Company has undergone a Section 382 analysis and does not believe there is currently a limitation on the use of NOLs under Section 382; however, due to ongoing ownership changes (See Note Twenty—Subsequent Event), the Company may be subject to significant limitations in the future. If a change in ownership is deemed to have occurred during the past three years, then it may be possible that the Company's NOL carryforward could be subject to limitation under Section 382 for tax return purposes. However, since its NOL carryforward is fully reserved with a valuation allowance, there would be no impact for financial statement purposes from a Section 382 limitation.

Note Sixteen — Loss Per Share

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

	2016	2015	2014
Net loss	$(21.0)	$(15.7)	$(14.2)
Dividends related to Series B convertible preferred stock[1]	(0.6)	(0.6)	(0.6)
Net loss available to common stockholders	$(21.6)	$(16.3)	$(14.8)
Per share of Common Stock			
Basic/diluted net loss available to common stockholders	$(0.86)	$(0.70)	$(0.74)
Weighted average shares outstanding (basic and diluted) (in millions)	25.21	23.26	19.92
Currently anti-dilutive common stock equivalents[2] (in millions)	1.73	2.21	2.02

(1) Dividends on 7% Series B convertible preferred stock (Series B stock) are cumulative and have been accrued from July 1, 2012 to December 31, 2016. The total accrued dividends are $2.6 million as of December 31, 2016, which will continue to be accrued until they are declared by the board of directors. Dividends related to Series B convertible preferred stock were accrued but not paid during 2016, 2015 and 2014.

(2) In periods in which there was a loss, the effect of Common Stock equivalents, which is primarily related to the Series B Stock, was not included in the diluted loss per share calculation as it was antidilutive.

Note Seventeen — Fair Value Measurements

The Company reports certain assets and liabilities at fair value. Fair value is an exit price and establishes a three-tier valuation hierarchy for ranking the quality and reliability of the information used to determine fair values. The first tier, Level 1, uses quoted market prices in active markets for identical assets or liabilities. Level 2 uses inputs, other than quoted market prices for identical assets or liabilities in active markets, which are observable either directly or indirectly. Level 3 uses unobservable inputs in which there are little or no market data, and requires the entity to develop its own assumptions. A financial asset or liability’s classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following table presents financial instruments measured at fair value measured on a recurring basis:

	December 31, 2016 Carrying value	Level 1	Level 2	Level 3
Cash and cash equivalents - money market fund	$12.1	$ 12.1	$ —	$ —
Warrant liability	0.8	—	—	0.8

	December 31, 2015 Carrying value	Level 1	Level 2	Level 3
Cash and cash equivalents - money market fund	$13.7	$ 13.7	$ —	$ —
Warrant liability	—	—	—	—

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

(In millions)	Amount
Level 3 warrants, ending balance at December 31, 2013	$ 0.8
Change in fair value of warrant liability	0.1
Warrant exercise	(0.5)
Level 3 warrants, ending balance at December 31, 2014	0.4
Change in fair value of warrant liability	—
Warrant exercise	(0.4)
Level 3 warrants, ending balance at December 31, 2015	—
Addition - Hercules warrants, initial fair value	0.9
Change in fair value of warrant liability	(0.1)
Level 3 warrants, ending balance at December 31, 2016	$ 0.8

The carrying values of other cash and cash equivalents, accounts receivable, accounts payable, and short-term debt approximated their fair values as of December 31, 2016 and December 31, 2015 due to the short-term nature of these instruments.

The company determined the fair value of the warrant liability, considered a Level 3 liability, using the Black-Scholes model. At December 31, 2016, management used a risk free rate of 2.18%, expected volatility of 53%, and an

expected term of 6.59 years. Initially, the warrant is exercisable for 357,142 shares of common stock. If the company borrows the entire third tranche of $5.0 million available under the Hercules secured loan agreement, the warrant will be exercisable for 428,570 shares of common stock. (See Note Ten – Other Current Liabilities). As of December 31, 2016, a probability of 0% was assigned to a draw of the third tranche Significant increases or decreases in any of these inputs in isolation would result in a significantly different fair value.

Fair values for assets and liabilities that are only disclosed and not recorded consist of long-term debt. The fair value of long-term debt was estimated to be $22.8 million at December 31, 2016.

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

Note Eighteen — Litigation and Other Contingencies

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

MATTERSIGHT CORPORATION

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Under its By-Laws, subject to certain exceptions, the Company has agreed to indemnify its corporate officers and directors for certain events or occurrences while the corporate officer or director is, or was, serving at its request in such capacity or in certain related capacities. The Company has separate indemnification agreements with each of its directors and corporate officers that requires it, subject to certain exceptions, to indemnify them to the fullest extent authorized or permitted by its By-Laws and the Delaware General Corporation Law. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited; however, the Company has a director and officer liability insurance policy that limits its exposure and enables it to recover a portion of any amounts paid under these indemnification agreements. As a result of its insurance policy coverage, the Company believes the estimated fair value of these indemnification agreements is minimal. The Company had no liabilities recorded for these agreements as of December 31, 2016.

The Company’s products may be subject to sales tax in certain jurisdictions. If a taxing authority were to successfully assert that we have not properly collected sales or other transaction taxes, or if sales or other transaction tax laws or the interpretation thereof were to change, and we were unable to enforce the terms of our contracts with customers that give us the right to reimbursement for assessed sales taxes, we could incur tax liabilities in amounts that could be material. The Company has considered the changing nature of tax laws, the terms of its customer contracts and its recent audit experience in assessing its exposure to possible and probable sales tax liabilities. Based on its assessment, the company has recorded a sales tax liability of less than $0.1 million at December 31, 2016.

Note Nineteen — Quarterly Data (Unaudited)

	2016				
	1st	2nd	3rd	4th	Year
Total revenue	$10.0	$9.1	$10.4	$12.6	$42.1
Gross margin	$6.8	$5.9	$7.0	$8.6	$28.3
Operating loss	$(5.6)	$(6.0)	$(5.0)	$(2.2)	$(18.8)
Loss before income taxes	$(5.8)	$(6.2)	$(5.8)	$(3.1)	$(20.9)
Net loss available to common stockholders	$(6.0)	$(6.3)	$(6.0)	$(3.3)	$(21.6)
Per share of common stock:					
Basic net loss available to common stockholders	$(0.24)	$(0.25)	$(0.24)	$(0.13)	$(0.86)
Diluted net loss available to common stockholders	$(0.24)	$(0.25)	$(0.24)	$(0.13)	$(0.86)

	2015				
	1st	2nd	3rd	4th	Year
Total revenue	$9.3	$9.7	$10.5	$10.4	$39.9
Gross margin	$6.7	$7.0	$8.0	$7.5	$29.2
Operating loss	$(3.7)	$(3.4)	$(3.8)	$(4.2)	$(15.1)
Loss before income taxes	$(3.8)	$(3.6)	$(3.9)	$(4.3)	$(15.6)

Net loss available to common stockholders	$(4.0)	$(3.7)	$(4.1)	$(4.5)	$(16.3)
Per share of common stock:					
Basic net loss available to common stockholders	$(0.18)	$(0.17)	$(0.17)	$(0.18)	$(0.70)
Diluted net loss available to common stockholders	$(0.18)	$(0.17)	$(0.17)	$(0.18)	$(0.70)

Note Twenty — Subsequent Event

On February 23, 2017, the Company, entered into a purchase agreement for the sale of 5,328,187 shares of its common stock to certain investors and certain officers and directors in a private placement. Under the terms of the agreement, the Company raised approximately $16.0 million in gross proceeds by selling 5,228,187 shares to certain investors at a price of $3.00 per share and by selling 100,000 shares to certain officers and directors (including certain of their affiliates) at a price of $3.45 per share. The Shares represented 20% of the issued and outstanding shares of common stock immediately prior to the issuance. On March 1, 2017, the Company received aggregate gross proceeds, net of fees, of $14.9 million. Proceeds are being used for general corporate and working capital purposes. Craig-Hallum Capital Group LLC, which acted as the sole placement agent for the offering, received a commission of $1.1 million, and will be reimbursed for its out-of-pocket expenses. The Company has agreed to register the shares and will be assessed penalties if it is unable to do so.

MATTERSIGHT CORPORATION

SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS

(In millions)

Description of Allowance and Reserves	Balance at Beginning of Period	Additions Charged to Costs and Expenses	Additions Charged to Other Accounts	Deductions	Balance at End of Period
Valuation allowance for doubtful accounts:					
December 31, 2016	$ —	0.3	—	—	$ 0.3
December 31, 2015	$ —	—	—	—	$ —
December 31, 2014	$ —	—	—	—	$ —
Valuation allowance for deferred tax assets:					
December 31, 2016	$ 75.8	8.0	—	—	$ 83.8
December 31, 2015	$ 71.0	4.8	—	—	$ 75.8
December 31, 2014	$ 67.6	3.4	—	—	$ 71.0

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Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.
Not applicable.

Item 9A. Controls and Procedures.
(a) Evaluation of Disclosure Controls and Procedures

Based on their evaluation for the period covered by this Annual Report on Form 10-K, Mattersight's Chief Executive Officer and Chief Financial Officer have concluded that, as of December 31, 2016, the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) were effective.

(b) Management's Annual Report on Internal Control over Financial Reporting

Mattersight's management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act). Due to its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate due to changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management, under the supervision of our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2016 based on the criteria established in the 2013 Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on its evaluation, our management concluded that our internal control over financial reporting was effective as of the end of the period covered by this Form 10-K.

(c) Attestation Report of the Registered Public Accounting Firm

Grant Thornton LLP, an independent registered public accounting firm, has audited the Consolidated Financial Statements included in this Annual Report on Form 10-K and, as part of its audit, has issued its report, included herein, on the effectiveness of our internal control over financial reporting. See Report of Grant Thornton LLP Independent Registered Public Accounting Firm on page 25, which is incorporated herein by reference.

(d) Changes in Internal Control over Financial Reporting

There has been no change in Mattersight's internal control over financial reporting that occurred during the Company's fourth fiscal quarter of 2016 that has materially affected, or is reasonably likely to materially affect, Mattersight's internal control over financial reporting.

Item 9B. Other Information.
Not applicable.

PART III

Item 10. Directors, Executive Officers and Corporate Governance.

For information about our corporate Directors and the committees of our Board of Directors, see the captions Election of Directors and Security Ownership of Certain Beneficial Owners and Management in the Proxy Statement to be filed by Mattersight for its 2017 Annual Meeting of Stockholders, which is incorporated herein by reference in response to this item.

The following table includes the name, age (as of March 6, 2017), and current position of each of our executive officers.

Name	Age	Current Position
Kelly D. Conway*	60	President and Chief Executive Officer
Christopher J. Danson	49	Executive Vice President and Chief Technology Officer
David R. Gustafson	39	Executive Vice President and Chief Operating Officer
David B. Mullen*	66	Senior Vice President and Chief Financial Officer

*Member of the Board of Directors

Except as required by individual employment agreements between executive officers and the Company, there exists no arrangement or understanding between any executive officer and any other person pursuant to which such executive officer was elected. Each executive officer serves until his or her removal or resignation.

The principal business experience of the executive officers for at least the last five years is as follows:

Kelly D. Conway has served as the President and Chief Executive Officer and a Director of the Company, since its incorporation in May 1999 as a subsidiary of Technology Solutions Company (TSC). Mr. Conway joined TSC in November 1993 as Senior Vice President, assumed the position of Executive Vice President in July 1995, and became Group President in October 1998. Prior to joining TSC, Mr. Conway served as a Partner in the management consulting firm of Spencer, Shenk and Capers and also held various positions, including President and Chief Executive Officer, with Telcom Technologies, a manufacturer of automatic call distribution equipment.

Christopher J. Danson has been Executive Vice President and Chief Technology Officer since August 2015, prior to which he served as Executive Vice President of Delivery since February 2012 and Vice President of Delivery since June 2011. Prior to these roles, Mr. Danson served as Vice President of ICS and CRM Delivery since January 2005. His responsibilities over at least the past five years have included executive leadership of the business and technical delivery functions, which encompasses product development, rules and analytics development/tuning, data centers, security, training and adoption, service delivery management, support operations and business intelligence. In total, Mr. Danson has spent over 20 years with the Company, having spent the first seven years of his tenure with TSC.

David R. Gustafson has served as the Company’s Executive Vice President and Chief Operating Officer since August 2015 (during which period he also served as interim Chief Financial Officer from June 2016 through December 2016). Mr. Gustafson was Executive Vice President of Products and Marketing during the period from July 2013 through August 2015 (during which period he served as interim Chief Financial Officer from March 2015 to July 2015), Executive Vice President of Product and Customer Operations during the period from May 2012 to June 2013, and Vice President of Marketing and Product Management during the period from February 2012 through May 2012. Mr. Gustafson also served as Vice President of BA Business Delivery during the period from September 2008 through

May 2012. Mr. Gustafson has responsibility for product management, product delivery, implementation services, service delivery, customer success, and the Company's behavioral and data science teams. In total, Mr. Gustafson has spent over 15 years at Mattersight.

David Mullen has served as Mattersight's Senior Vice President and Chief Financial Officer since January 2017 and as a member of the Company's board of directors since March 2009. Prior to joining the Company as its Senior Vice President and Chief Financial Officer, Mr. Mullen acted as an independent consultant until December 2016. Mr. Mullen is the former Executive Vice President and Chief Financial Officer of Navteq Corporation, having held that position from December 2002 to January 2010. Navteq was acquired by Nokia Corporation (NYSE: NOK) in July 2008. Mr. Mullen served as a director and Audit Committee member of Avid Technology, Inc. (NASDAQ: AVID) until October 2014. He currently serves as a director and Audit Committee member of Angie's List, Inc. (NASDAQ: ANGI).

The Company maintains a code of ethical business conduct (the Code of Conduct) applicable to all of our directors, officers, and other employees, including our Chief Executive Officer and Chief Financial Officer (who serves as our principal financial officer) and Vice President and Controller (who serves as our Principal Accounting Officer). The Code of Conduct addresses ethical conduct, SEC disclosure, legal compliance, and other matters as contemplated by Section 406 of the Sarbanes-Oxley Act of 2002. A copy of the Code of Conduct is available on our website at www.Mattersight.com. We will make a copy of it available to any person, without charge, upon written request to Mattersight Corporation, 200 W. Madison Street, Suite 3100, Chicago, Illinois 60606, Attn: Legal Department. To the extent permitted by applicable rules of the NASDAQ Global Market, we intend to satisfy the disclosure requirement under Item 5.05 of Form 8-K regarding amendments to or waivers of the Code of Conduct for our Chief Executive Officer or Chief Financial Officer by posting such information on our website.

Item 11. Executive Compensation.

The information under Executive Compensation, and Director Compensation in the Proxy Statement to be filed by the Company for its 2017 Annual Meeting of Stockholders is incorporated herein by reference in response to this item.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The information under the heading Security Ownership of Certain Beneficial Owners and Management in the Proxy Statement to be filed by the Company for its 2017 Annual Meeting of Stockholders is incorporated herein by reference in response to this item.

The following table shows, as of December 31, 2016, information regarding outstanding awards under all compensation plans of the Company (including individual compensation arrangements) under which equity securities of the Company may be delivered:

Plan Category	Shares of Common Stock to be Issued Upon Exercise of Outstanding Options and Rights[1]	Weighted Average Exercise Price of Outstanding Options and Rights	Shares of Common Stock Remaining Available for Future Issuance Under Compensation Plans (excluding securities

				reflected in column[2]	
Equity compensation plans approved by security holders	2,592,141	$	7.36	2,557,129	(3)
Equity compensation plans not approved by security holders[4]	—	$	—	—	
Total	2,592,141	$	7.36	2,557,129	(5)

(1) Excludes purchase rights currently accruing under the ESPP. Purchase periods under the ESPP are three-month periods, beginning on the first business day of and ending on the last business day of each quarter. Eligible employees may purchase shares of our Common Stock at a price equal to 85% of the lower of (i) the fair market value of our Common Stock on the first day of a purchase period or (ii) the fair market value of our Common Stock on the last day of a purchase period.

(2) All of the securities available for future issuance listed herein may be issued other than upon the exercise of outstanding options, or similar rights. All of these shares are available for an award in the form of restricted stock, bonus stock, or similar awards under the Company's applicable equity compensation plans.

(3) Consists of 2,471,347 shares of Common Stock reserved for issuance under the 1999 Plan and 85,782 shares of Common Stock reserved for issuance under the ESPP. The Company's 1999 Plan and ESPP have both been approved by the Company's stockholders. The 1999 Plan includes an automatic increase feature whereby, as of the first day of each fiscal year, the number of shares of Common Stock available for awards, other than incentive stock options, automatically increases by an amount equal to 5% of the number of shares of Common Stock then outstanding.

(4) There are currently no equity compensation plans that have not been approved by the Company's stockholders.

(5) Does not include shares of restricted Common Stock held by employees, of which 1,183,753 shares were issued and outstanding as of December 31, 2016, which are included in the amount of issued and outstanding shares.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

The information under the heading Board Leadership and Corporate Governance—Transactions with Related Persons in the Proxy Statement to be filed by Mattersight for its 2017 Annual Meeting of Stockholders is incorporated herein by reference in response to this item.

Item 14. Principal Accounting Fees and Services.

The information under the caption Principal Accounting Fees and Services in the Proxy Statement to be filed by the Company for its 2017 Annual Meeting of Stockholders is incorporated herein by reference in response to this item.

PART IV

Item 15. Exhibits and Financial Statement Schedules.

(a) Documents filed as part of this report:

(1) Financial Statements.

The consolidated financial statements filed as part of this report are listed and indexed under Item 8 of this Annual Report on Form 10-K and such list is incorporated herein by reference.

(2) Financial Statement Schedule.

The financial statement schedule filed as part of this report is listed and indexed under Item 8 of this Annual Report on Form 10-K and is incorporated herein by reference. We have omitted financial statement schedules other than that listed under Item 8 because such schedules are not required or applicable.

(3) Exhibits.

The list of exhibits filed with or incorporated by reference into this report is contained in the Exhibit Index to this report on Page I-1, which is incorporated herein by reference.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this Annual Report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized, on March 16, 2017.

MATTERSIGHT CORPORATION

By /S/ KELLY D. CONWAY
Kelly D. Conway
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this Annual Report on Form 10-K has been signed below by the following persons on behalf of the registrant in the capacities indicated on March 16, 2017.

Name	Capacity
/S/ KELLY D. CONWAY Kelly D. Conway	Director, President and Chief Executive Officer (Principal Executive Officer)
* Tench Coxe	Chairman of the Board and Director
* Philip R. Dur	Director
* Henry J. Feinberg	Director
* John T. Kohler	Director
* Michael J. Murray	Director
* John C. Staley	Director
/s/ DAVID B. MULLEN David B. Mullen	Director, Senior Vice President and Chief Financial Officer

	(Principal Financial Officer)
/S/ ROSE CAMMARATA Rose Cammarata	Vice President and Controller (Principal Accounting Officer)

*By: /S/ DAVID B. MULLEN
David B. Mullen, Attorney-in-Fact

EXHIBIT INDEX

We are including as exhibits to this Annual Report on Form 10-K certain documents that we have previously filed with the SEC as exhibits, and we are incorporating such documents as exhibits herein by reference from the respective filings identified in parentheses below. The management contracts and compensatory plans or arrangements required to be filed as exhibits to this Annual Report on Form 10-K pursuant to Item 15(a)(3) are those listed below as Exhibits and noted by an asterisk. Unless otherwise indicated below, all items incorporated by reference were filed with the SEC under File No. 000-27975.

Exhibit No.	Description of Exhibit
3(i).1	Certificate of Incorporation of Mattersight Corporation, as amended (incorporated by reference to Exhibit 3.1 to Amendment No. 1 to Mattersight Corporation's Registration Statement on Form S-1 (File No. 333-94293) filed with the SEC on February 1, 2000 (the "S-1")).
3(i).2	Certificate of Amendment to Mattersight Corporation's Certificate of Incorporation effective December 19, 2001 (incorporated by reference to Exhibit 3.3 to Mattersight Corporation's Annual Report on Form 10-K for the year ended December 29, 2001 filed with the SEC on March 28, 2002).
3(i).3	Certificate of Amendment to Mattersight Corporation's Certificate of Incorporation effective December 19, 2001 (incorporated by reference to Exhibit 3.4 to Mattersight Corporation's Annual Report on Form 10-K for the year ended December 29, 2001 filed with the SEC on March 28, 2002).
3(i).4	Certificate of Amendment to Mattersight Corporation's Certificate of Incorporation effective May 31, 2011 (incorporated by reference to Exhibit 3.1 to Mattersight Corporation's Current Report on Form 8-K filed with the SEC on May 31, 2011).
3(ii).1	By-Laws of Mattersight Corporation (incorporated by reference to Exhibit 3.2 to the S-1).
3(ii).2	Amendment to By-Laws of Mattersight Corporation (incorporated by reference to Exhibit 3.1 to Mattersight Corporation's Current Report on Form 8-K filed with the SEC on November 16, 2007).
4.1	Certificate of Designations of Series A Junior Participating Preferred Stock of Mattersight Corporation (incorporated by reference to Exhibit 4.2 to Amendment No. 1 to Mattersight Corporation's Registration Statement on Form 8-A filed with the SEC on March 24, 2000).
4.2	Certificate of Increase of Series A Junior Participating Preferred Stock of Mattersight Corporation, filed December 19, 2001 (incorporated by reference to Exhibit 3.5 to Mattersight Corporation's Annual Report on Form 10-K for the year ended December 29, 2001 filed with the SEC on March 28, 2002).
4.3	Certificate of Designations of 7% Series B Convertible Preferred Stock of Mattersight Corporation, filed December 19, 2001 (incorporated by reference to Exhibit 3.6 to Mattersight Corporation's Annual Report on Form 10-K for the year ended December 29, 2001 filed with the SEC on March 28, 2002).
4.4	Certificate of Adjustment dated January 10, 2002 (incorporated by reference to Exhibit 4.3 to Mattersight Corporation's Annual Report on Form 10-K for the year ended December 29, 2001 filed with the SEC on March 28, 2002).

4.5	Form of Common Stock Certificate (incorporated by reference to Exhibit No. 4.1 to Mattersight Corporation's Registration Statement on Form S-1/A filed with the SEC on August 8, 2006).
4.6	Current Form of Common Stock Certificate (adopted as of December 3, 2013) (incorporated by reference to Exhibit 4.6 to Mattersight Corporation's Annual Report on Form 10-K for the year ended December 30, 2013 filed with the SEC on March 13, 2014).
10.1*	Mattersight Corporation 1999 Stock Incentive Plan (Conformed Copy as Amended through November 5, 2014) (incorporated by reference to Exhibit 10.1 to Mattersight Corporation's Annual Report on Form 10-K for the year ended December 31, 2014 filed with the SEC on March 12, 2015).
10.2*	Mattersight Corporation 1999 Employee Stock Purchase Plan (as Amended and Restated effective February 16, 2016) (incorporated by reference to Exhibit 10.2 to Mattersight Corporation's Annual Report on Form 10-K for the year ended December 31, 2015 filed with the SEC on March 11, 2016).
10.3*	Form of Restricted Stock Award Agreement between applicable participant and Mattersight Corporation (incorporated by reference to Exhibit 10.23 to Mattersight Corporation's Annual Report on Form 10-K for the year ended January 1, 2005 filed with the SEC on March 25, 2005).

Exhibit No.	Description of Exhibit
10.4*	Current Form of Restricted Stock Award Agreement between applicable participant and Mattersight Corporation (incorporated by reference to Exhibit 10.4 to Mattersight Corporation's Annual Report on Form 10-K for the year ended December 31, 2015 filed with the SEC on March 11, 2016).
10.5*	Form of Installment Stock Award Agreement between applicable participant and Mattersight Corporation (incorporated by reference to Exhibit 10.24 to Mattersight Corporation's Annual Report on Form 10-K for the year ended January 1, 2005 filed with the SEC on March 25, 2005).
10.6*	Form of Option Award Agreement between applicable participant and Mattersight Corporation (incorporated by reference to Exhibit 10.8 to Mattersight Corporation's Annual Report on Form 10-K for the year ended December 30, 2006 filed with the SEC on March 13, 2007).
10.7*	Current Form of Option Award Agreement between applicable participant and Mattersight Corporation (incorporated by reference to Exhibit 10.7 to Mattersight Corporation's Annual Report on Form 10-K for the year ended December 31, 2015 filed with the SEC on March 11, 2016).
10.8*	Loan and Security Agreement between Mattersight Corporation and Hercules Capital, Inc., dated August 1, 2016 (incorporated by reference to Exhibit 10.1 to Mattersight Corporation's Current Report on Form 8-K filed with the SEC on August 5, 2016).
10.9*	Warrant Agreement between Mattersight Corporation and Hercules Capital, Inc., dated August 1, 2016 (incorporated by reference to Exhibit 10.2 to Mattersight Corporation's Current Report on Form 8-K filed with the SEC on August 5, 2016).
10.10	Form of Common Stock Purchase Agreement dated July 23, 2014 by and between Mattersight Corporation and the purchasers named therein (incorporated by reference to Exhibit 10.1 to Mattersight Corporation's Current Report on Form 8-K filed with the SEC on July 24, 2014).
10.11*	Form of Purchase Agreement dated July 22, 2015 by and between Mattersight Corporation and the purchasers named therein (incorporated by reference to Exhibit 10.1 to Mattersight Corporation's Current Report on Form 8-K filed with the SEC on July 23, 2015).
10.12*	Form of Indemnification Agreement entered into between Mattersight Corporation and participant (incorporated by reference to Exhibit 10.12 to Mattersight Corporation's Annual Report on Form 10-K for the year ended December 31, 2012 filed with the SEC on March 14, 2013).
10.13*	Second Amended and Restated Employment Agreement, effective as of April 19, 2011 between Kelly D. Conway and Mattersight Corporation (incorporated by reference to Exhibit 10.3 to Mattersight Corporation's Quarterly Report on Form 10-Q for the quarter ended April 2, 2011 filed with the SEC on May 12, 2011).
10.14*	First Amendment to Second Amended and Restated Employment Agreement, dated March 17, 2015, between Kelly D. Conway and Mattersight Corporation (incorporated by reference to Exhibit 10.1 to Mattersight Corporation's Quarterly Report on Form 10-Q for the quarter ended March 31, 2015 filed with the SEC on May 7, 2015).
10.15*	

Amended and Restated Executive Employment Agreement, effective as of September 8, 2008, between Christopher J. Danson and Mattersight Corporation (incorporated by reference to Exhibit 10.31 to Mattersight Corporation's Annual Report on Form 10-K for the year ended December 27, 2008 filed with the SEC on March 11, 2009).

10.16* Executive Employment Agreement, effective as of May 23, 2012, between David R. Gustafson and Mattersight Corporation (incorporated by reference to Exhibit 10.22 to Mattersight Corporation's Annual Report on Form 10-K for the year ended December 31, 2012 filed with the SEC on March 14, 2013).

10.17* First Amendment to Executive Employment Agreement, dated July 1, 2013, between David R. Gustafson and Mattersight Corporation (incorporated by reference to Exhibit 10.1 to Mattersight Corporation's Current Report on Form 8-K filed with the SEC on July 3, 2013).

10.18* Second Amendment to Executive Employment Agreement, dated August 8, 2013, between David R. Gustafson and Mattersight Corporation (incorporated by reference to Exhibit 10.1 to Mattersight Corporation's Current Report on Form 8-K filed on August 13, 2013).

10.19* Executive Employment Agreement, effective as of January 3, 2017, between David B. Mullen and Mattersight Corporation (incorporated by reference to Exhibit 10.1 to Mattersight Corporation's Current Report on Form 8-K filed with the SEC on January 3, 2017).

Exhibit No.	Description of Exhibit
10.20*	Executive Employment Agreement, effective as of February 10, 2014, between Richard Dresden and Mattersight Corporation (filed as Exhibit 10.26 to Mattersight Corporation's Annual Report on Form 10-K for the year ended December 30, 2013).
10.21*	First Amendment to Executive Employment Agreement, dated November 24, 2014, between Richard Dresden and Mattersight Corporation (filed as Exhibit 10.19 to Mattersight Corporation's Annual Report on Form 10-K for the year ended December 31, 2014).
10.22*	Executive Employment Agreement between Mattersight Corporation and Sheau-ming Ross effective July 6, 2015 (filed on July 7, 2015 as Exhibit 10.1 to Mattersight Corporation's Current Report on Form 8-K).
10.23*	Lease Agreement, effective as of March 20, 2015, between MEPT 200 WEST MADISON LLC and Mattersight Corporation (filed as Exhibit 10.22 to Mattersight Corporation's Annual Report on Form 10-K for the year ended December 30, 2015).
10.24+	Summary of Director Compensation.
10.25+	Summary of 2017 Executive Officer Compensation.
21.1+	Subsidiaries of Mattersight Corporation.
23.1+	Consent of Grant Thornton LLP.
24.1+	Power of Attorney from Tench Coxe, Director.
24.2+	Power of Attorney from Philip R. Dur, Director.
24.3+	Power of Attorney from Henry J. Feinberg, Director.
24.4+	Power of Attorney from John T. Kohler, Director.
24.5+	Power of Attorney from Michael J. Murray, Director.
24.6+	Power of Attorney from John C. Staley, Director.
31.1+	Certification of Kelly D. Conway under Section 302 of the Sarbanes-Oxley Act of 2002.
31.2+	Certification of David B. Mullen under Section 302 of the Sarbanes-Oxley Act of 2002.
32.1+	Certification of Kelly D. Conway and David B. Mullen under Section 906 of the Sarbanes-Oxley Act of 2002.
101+**	The following financial information from the Company's Annual Report on Form 10-K for the year ended December 31, 2016, is formatted in eXtensible Business Reporting Language (XBRL): (i) Consolidated Balance Sheets as of December 31, 2016 and December 31, 2015; (ii) Consolidated Statements of Operations for the years ended December 31, 2016, December 31, 2015, and December 31, 2014; (iii) Consolidated Statements of Comprehensive Loss for the years ended December 31, 2016, December 31,

2015, and December 31, 2014; (iv) Consolidated Statements of Cash Flows for the years ended December 31, 2016, December 31, 2015, and December 31, 2014; (v) Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2016, December 31, 2015, and December 31, 2014; (vi) notes to the Consolidated Financial Statements; and (vii) Financial Statement Schedule II.

+Filed herewith.
*Represents a management contract or compensatory plan or arrangement.
**The XBRL information is filed herewith.