Mattersight Corp
Form 10-K/A
May 14, 2012
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K/A

(Amendment No. 1)

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2011

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

200 S. Wacker Drive, Suite 820

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 x

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 x

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 x 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 x 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 Form 10-K or any amendment to this 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. (Check one):

Large accelerated filer	¨	Accelerated filer	x
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 x

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 July 1, 2011, as reported by The NASDAQ Stock Market LLC, is approximately $79,833,592.

The number of shares of the registrant s Common Stock outstanding as of March 9, 2012 was 16,784,717.

Table of Contents

Explanatory Note

This Amendment No. 1 (the Amendment No. 1) on Form 10-K/A (the Form 10-K/A) amends the Annual Report on Form 10-K for the fiscal year ended December 31, 2011 (the Original Form 10-K), originally filed by Mattersight Corporation (Mattersight , Company , our , us or we with the Securities and Exchange Commission (the SEC) on March 15, 2012. The following items have been amended:

PART II	Item 6	Selected Financial Data
PART II	Item 8	Financial Statements and Supplementary Data
PART II	Item 9A	Controls and Procedures
PART IV	Item 15	Exhibits and Financial Statement Schedules

As disclosed in a Current Report on Form 8-K we filed with the SEC on May 10, 2011, Mattersight s audit committee of the board of directors, upon recommendation from Mattersight s management, concluded that the basic and diluted loss per share from continuing operations in the previously issued financial statements were incorrectly calculated. Specifically, the calculation of basic and diluted loss per share from continuing operations did not deduct dividends and in 2011, other payments made in respect of the Series B Stock, in accordance with Accounting Standards Codification 260, *Earnings Per Share* . As a result, the Board of Directors determined that the previously issued financial statements for the fiscal years ended December 26, 2009, January 1, 2011, and December 31, 2011 and for the quarterly periods ended April 2, 2011, July 2, 2011, October 1, 2011, and December 31, 2011 should no longer be relied upon. Accordingly, Mattersight is hereby restating its Consolidated Statements of Operations for the requisite periods to correct basic and diluted loss per share from continuing operations. The error had no other effect on any other amounts or financial statement line items.

This Form 10-K/A is being filed to restate our financial statements for the fiscal years ended December 26, 2009, January 1, 2011 and December 31, 2011. Because this Form 10-K/A restates the basic and diluted loss per share from continuing operations for each of the quarterly periods for fiscal years 2010 and 2011, the Company does not plan on amending previously filed 10-Qs.

A more detailed description of the restatements made to the financial statements is provided at Note Twenty-Two to the consolidated financial statements included with this report.

The Company has amended Part II Item 9A of this Form 10-K/A including Management s Annual Report on Internal Control Over Financial Reporting to update the disclosure regarding disclosure controls and procedures and internal control over financial reporting.

Item 15 of Part IV of this Form 10-K/A has been amended to contain the currently-dated certifications from our Chief Executive Officer and Chief Financial Officer, as required by Section 302 and 906 of the Sarbanes-Oxley Act of 2002.

Except as described above, no other amendments are being made to the disclosures presented in the Original Form 10-K. This Amendment No. 1 does not reflect events occurring after the filing of the Original Form 10-K, or modify or update the disclosures contained therein in any other way other than as required to reflect the amendments discussed above. Information not affected by the restatement is unchanged and reflects the disclosures made at the time of the filing of the Original Form 10-K with the SEC on March 15, 2012. Accordingly, this Amendment No. 1 should be read in its historical context and in conjunction with our filings made with the SEC subsequent to the filing of the Original Form 10-K, as information in such filings may update or supersede certain information contained in this Amendment No. 1.

Table of Contents

TABLE OF CONTENTS

Forward-Looking Statements

Statements in this Form 10-K/A that are not historical facts are forward-looking statements that 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 the Original Form 10-K for the year ended December 31, 2011. We cannot guarantee any future results, levels of activity, performance, or achievements. We assume no obligation to update forward-looking statements, except as may be required by law.

Table of Contents

Item 6. ***Selected Financial Data.***

The following tables summarize our selected financial data. This information should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations included in the Original Form 10-K, and the Consolidated Financial Statements of the Company and notes thereto included elsewhere in this Form 10-K/A.

	(In thousands, except per share data)[1]				
	December 31, 2011	January 1, 2011	December 26, 2009	December 27, 2008	December 29, 2007[2]
Total revenue	$ 29,095	$ 30,885	$ 32,563	$ 37,483	$ 102,105
Loss from continuing operations	$ (10,560)	$ (16,304)	$ (15,354)	$ (25,733)	$ (18,738)
Basic loss from continuing operations per share, as restated[3]	$ (1.29)	$ (1.28)	$ (1.26)	$ (2.61)	$ (2.40)
Total assets	$ 49,265	$ 66,192	$ 70,603	$ 64,223	$ 60,051
Long-term obligations	$ 4,437	$ 6,247	$ 5,368	$ 6,117	$ 9,041
Series B Stock, $0.01 par value	$ 8,521	$ 18,100	$ 18,442	$ 18,460	$ 19,100
Capital leases	$ 2,823	$ 2,217	$ 2,410	$ 2,975	$ 1,491

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

(2) The December 29, 2007 data is not adjusted for discontinued operations because it would be impractical to determine this information.

(3) The effects of the correction of the error reported in Note Twenty-Two Restatement Basic and Diluted Loss Per Share from Continuing Operations of the Notes to Consolidated Financial Statements included in Part II Item 8 of this Form 10-K/A are reflected in all periods presented.

Table of Contents

Item 8. ***Financial Statements and Supplementary Data.***

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS OF MATTERSIGHT CORPORATION

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors

Mattersight Corporation

We have audited Mattersight Corporation s (a Delaware Corporation) internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control Integrated Fram*ework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Mattersight Corporation 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. Our responsibility is to express an opinion on Mattersight Corporation 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.

A material weakness is a deficiency, or combination of control deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company s annual or interim financial statements will not be prevented or detected on a timely basis. The following material weakness has been identified and included in management s assessment. Management identified a material weakness in internal control related to their process and procedures used in applying appropriate accounting to basic and diluted loss per share from continuing operations. This material weakness resulted in the restatement of the annual consolidated financial statements as of and for the years ended December 26, 2009, January 1, 2011, and December 31, 2011.

In our opinion, because of the effect of the material weakness described above on the achievement of the objectives of the control criteria, Mattersight Corporation has not maintained effective internal control over financial reporting as of December 31, 2011, based on the criteria established in *Internal Control Integrated Framework* issued by COSO.

We do not express an opinion or any other form of assurance on management s statement referring to the change in the internal control process and procedures of the material weakness.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Mattersight Corporation as of December 31, 2011 and January 1, 2011, and the related consolidated statements of operations, changes in stockholders equity (deficit) and comprehensive loss and cash flows for each of the three years in the period ended December 31, 2011. The material weakness identified above was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2011 financial statements, and this report does not affect our report dated May 14, 2012, which expressed an unqualified opinion on those financial statements.

Chicago, Illinois

May 14, 2012

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders

Mattersight Corporation

We have audited the accompanying consolidated balance sheets of Mattersight Corporation (a Delaware corporation) and subsidiaries as of December 31, 2011 and January 1, 2011, and the related consolidated statements of operations, changes in stockholders equity (deficit) and comprehensive loss and cash flows for each of the three years in the period ended December 31, 2011. Our audit of the basic consolidated financial statements included the financial statement schedules listed in the index appearing under Schedule II- Valuation and 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 schedules 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, 2011 and January 1, 2011, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related financial statement schedules, when considered in relation to the basic financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

As discussed in Note Twenty-Two the previously issued consolidated financial statements as of and for the years ended December 26, 2009, January 1, 2011, and December 31, 2011, were restated for the correction of an error.

We also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Mattersight Corporations internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control- Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated May 14, 2012, expressed an adverse opinion.

Chicago, Illinois

May 14, 2012

Table of Contents

MATTERSIGHT CORPORATION

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

	December 31, 2011	January 01, 2011
ASSETS:		
Current Assets:		
Cash and cash equivalents	$ 29,408	$ 20,872
Restricted cash	1,500	2,460
Receivables, net	2,540	2,041
Prepaid expenses	5,302	4,303
Other current assets	288	296
Current assets held for sale		26,946
Total current assets	39,038	56,918
Equipment and leasehold improvements, net	4,271	4,397
Goodwill	972	972
Intangibles, net	238	323
Other long-term assets	4,746	3,582
Total assets	$ 49,265	$ 66,192
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT):		
Current Liabilities:		
Short-term debt	$ 3,567	$
Accounts payable	812	372
Accrued compensation and related costs	1,382	2,048
Unearned revenue	9,783	7,884
Other current liabilities	3,673	4,262
Current liabilities held for sale		31,433
Total current liabilities	19,217	45,999
Long-term unearned revenue	3,036	4,686
Other long-term liabilities	1,401	1,561
Total liabilities	23,654	52,246
Series B Stock, $0.01 par value; 5,000,000 shares authorized and designated; 1,670,696 and 3,549,078 shares issued and outstanding at December 31, 2011 and January 1, 2011, respectively, with a liquidation preference of $8,819 and $19,367 at December 31, 2011 and January 1, 2011, respectively	8,521	18,100
Stockholders Equity (Deficit):		
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; 18,037,552 and 15,642,822 shares issued at December 31, 2011 and January 1, 2011, respectively; and 16,935,204 and 14,786,005 outstanding at December 31, 2011 and January 1, 2011, respectively	180	156
Additional paid-in capital	212,618	207,985
Accumulated deficit	(185,779)	(204,139)
Treasury stock, at cost, 1,102,348 and 856,817 shares at December 31, 2011 and January 1, 2011, respectively	(5,891)	(4,468)
Accumulated other comprehensive loss	(4,038)	(3,688)

Total stockholders equity (deficit)		17,090		(4,154)
Total liabilities and stockholders equity (deficit)	$	49,265	$	66,192

See accompanying notes to consolidated financial statements.

Table of Contents

MATTERSIGHT CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	For the Fiscal Years Ended		
	2011	**2010**	**2009**
Revenue:			
Behavioral Analytics revenue	$ 27,257	$ 25,246	$ 19,636
Other revenue	1,519	5,014	12,189
Total services revenue	28,776	30,260	31,825
Reimbursed expenses	319	625	738
Total revenue	29,095	30,885	32,563
Operating expenses:			
Cost of Behavioral Analytics revenue	12,188	11,999	11,892
Cost of Other revenue	1,000	3,511	8,127
Cost of services	13,188	15,510	20,019
Reimbursed expenses	319	625	738
Total cost of revenue, exclusive of depreciation and amortization shown below:	13,507	16,135	20,757
Sales, marketing and development	19,954	18,640	15,238
General and administrative	9,144	10,082	9,838
Severance and related costs	(336)	494	970
Depreciation	3,218	3,291	3,752
Amortization of intangibles	177	132	219
Total operating expenses	45,664	48,774	50,774
Operating loss	(16,569)	(17,889)	(18,211)
Interest and other income (expense), net	125	(121)	53
Loss from continuing operations before income taxes	(16,444)	(18,010)	(18,158)
Income tax benefit	5,884	1,706	2,804
Loss from continuing operations	(10,560)	(16,304)	(15,354)
Income from discontinued operations, net of tax	28,920	2,986	4,734
Net income (loss)	18,360	(13,318)	(10,620)
Series B Stock fair value over stated value	(6,555)		
Dividends related to Series B Stock	(1,252)	(1,273)	(1,292)
Net income (loss) available to common stockholders	$ 10,553	$ (14,591)	$ (11,912)
Per common share:			
Basic loss from continuing operations, as restated	$ (1.29)	$ (1.28)	$ (1.26)
Basic income from discontinued operations	$ 2.03	$ 0.22	$ 0.36

Basic net income (loss) available to common stockholders	$ 0.74	$ (1.06)	$ (0.90)
Diluted loss from continuing operations, as restated	$ (1.29)	$ (1.28)	$ (1.26)
Diluted income from discontinued operations	$ 2.03	$ 0.22	$ 0.36
Diluted net income (loss) available to common stockholders	$ 0.74	$ (1.06)	$ (0.90)
Shares used to calculate basic net income (loss) per share	14,225	13,701	13,255
Shares used to calculate diluted net income (loss) per share	14,225	13,701	13,255
Stock-based compensation, primarily restricted stock, is included in individual line items above:			
Cost of Behavioral Analytics revenue	$ 20	$ 68	$ 225
Sales, marketing and development	3,387	2,484	2,832
General and administrative	2,013	1,840	1,707
Discontinued operations	1,175	809	1,533

See accompanying notes to consolidated financial statements.

Table of Contents

MATTERSIGHT CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	For the Fiscal Years Ended		
	2011	**2010**	**2009**
Cash Flows from Operating Activities:			
Net income (loss)	$ 18,360	$ (13,318)	$ (10,620)
Less: net income from discontinued operations	28,920	2,986	4,734
Net loss from continuing operations	(10,560)	(16,304)	(15,354)
Adjustments to reconcile net loss from continuing operations to net cash (used in) provided by operating activities:			
Depreciation and amortization	3,395	3,423	3,971
Stock-based compensation	5,420	4,392	4,773
Other	14	16	358
Changes in assets and liabilities:			
Receivables	(554)	1,422	579
Prepaid expenses	(2,254)	953	(2,448)
Other assets	128	(19)	(251)
Accounts payable	445	(575)	(73)
Accrued compensation and related costs	(264)	(1,311)	220
Unearned revenue	275	(1,641)	6,892
Other liabilities	(6,554)	(1,798)	(3,092)
Total Adjustments	51	4,862	10,929
Net cash used in continuing operations	(10,509)	(11,442)	(4,425)
Net cash (used in) provided by discontinued operations	(5,787)	8,431	12,168
Net cash (used in) provided by operating activities	(16,296)	(3,011)	7,743
Cash Flows from Investing Activities:			
Capital expenditures and other	(833)	(1,219)	(2,912)
Proceeds from sale/leaseback of assets		423	
Sale of short-term investments			337
Net cash used in continuing investing activities	(833)	(796)	(2,575)
Net cash provided by (used in) discontinued investing activities	37,427	(1,593)	(415)
Net cash provided by (used in) investing activities	36,594	(2,389)	(2,990)
Cash Flows from Financing Activities:			
Purchase of shares of Series B Stock	(12,547)		
Proceeds from issuance of Common Stock	6,000		
Payment of Series B Stock dividends	(2,221)	(1,297)	(649)
Principal payments under capital lease obligations	(1,862)	(1,578)	(1,299)
Acquisition of treasury stock	(1,008)	(991)	(634)
Decrease (increase) in restricted cash	960	1,285	(90)
Proceeds from stock compensation and employee stock purchase plans, net	126	202	141

Net cash used in continuing financing activities	(10,552)	(2,379)	(2,531)
Net cash used in discontinued financing activities	(678)	(292)	(289)
Net cash used in financing activities	(11,230)	(2,671)	(2,820)
Effect of exchange rate changes on cash and cash equivalents by continuing operations	(299)	(65)	(34)
Effect of exchange rate changes on cash and cash equivalents by discontinued operations	(233)	26	19
Effect of exchange rate changes on cash and cash equivalents	(532)	(39)	(15)
Increase (decrease) in cash and cash equivalents	8,536	(8,110)	1,918
Cash and cash equivalents, beginning of period	20,872	28,982	27,064
Cash and cash equivalents of continuing operations, end of period	$ 29,408	$ 20,872	$ 28,982
Non-Cash Investing and Financing Transactions:			
Capital lease obligations incurred	$ 2,517	$ 1,385	$ 762
Capital equipment purchased on credit	2,517	1,385	762
Change in net unrealized security loss			108
Supplemental Disclosures of Cash Flow Information:			
Interest paid	$ 187	$ 157	$ 356

See accompanying notes to consolidated financial statements.

Table of Contents

MATTERSIGHT CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY (DEFICIT)

AND COMPREHENSIVE INCOME (LOSS)

(In thousands, except share data)

	Common Stock Issued						
	Shares	Amount	Additional Paid-in Capital	(Accumulated Deficit)	Treasury Stock	Accumulated Other Compre-hensive Loss	Total Stock-holders Equity (Deficit)
Balance, December 27, 2008	14,152,702	$ 142	$ 198,853	$ (180,201)	$ (2,457)	$ (3,490)	$ 12,847
Net loss				(10,620)			(10,620)
Foreign currency translation						(31)	(31)
Unrealized loss on marketable securities						(108)	(108)
Comprehensive loss							(10,759)
Issuance of Common Stock for option awards exercised	1,000		3				3
Issuance of Common Stock related to employee stock programs	736,482	7	461				468
Amortization/forfeitures of unearned compensation	(22,031)		5,584				5,584
Purchase of treasury shares					(838)		(838)
Series B Stock conversions	3,368		18				18
Series B Stock dividend			(1,292)				(1,292)
Balance, December 26, 2009	14,871,521	$ 149	$ 203,627	$ (190,821)	$ (3,295)	$ (3,629)	$ 6,031
Net loss				(13,318)			(13,318)
Foreign currency translation						(59)	(59)
Comprehensive loss							(13,377)
Issuance of Common Stock for option awards exercised	895		2				2
Issuance of Common Stock related to employee stock programs	731,010	6	325				331
Amortization/forfeitures of unearned compensation	(27,695)		4,963				4,963
Purchase of treasury shares					(1,173)		(1,173)
Series B Stock conversions	67,091	1	341				342
Series B Stock dividend			(1,273)				(1,273)
Balance, January 1, 2011	15,642,822	$ 156	$ 207,985	$ (204,139)	$ (4,468)	$ (3,688)	$ (4,154)

11

Table of Contents

MATTERSIGHT CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY (DEFICIT)

AND COMPREHENSIVE INCOME (LOSS) (CONTINUED)

(In thousands, except share data)

	Common Stock Issued					Accumulated Other Compre- hensive Loss	Total Stock- holders Equity (Deficit)
	Shares	Amount	Additional Paid-in Capital	(Accumulated Deficit)	Treasury Stock		
Balance, January 1, 2011	15,642,822	$ 156	$ 207,985	$ (204,139)	$ (4,468)	$ (3,688)	$ (4,154)
Net income				18,360			18,360
Foreign currency translation						(350)	(350)
Comprehensive income							18,010
Proceeds from issuance of Common Stock	1,252,609	12	5,988				6,000
Issuance of Common Stock related to employee stock programs	1,258,289	12	155				167
Amortization/forfeitures of unearned compensation	(101,125)		6,493				6,493
Retire treasury shares	(20,620)		(224)		224		
Purchase of treasury shares					(1,647)		(1,647)
Series B Stock retired			(6,555)				(6,555)
Series B Stock conversions	5,577		28				28
Series B Stock dividend			(1,252)				(1,252)
Balance, December 31, 2011	18,037,552	$ 180	$ 212,618	$ (185,779)	$ (5,891)	$ (4,038)	$ 17,090

See accompanying notes to consolidated financial statements.

Table of Contents

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Note One Description of Business

Mattersight is a leader in enterprise analytics focused on customer and employee interactions and behaviors. Mattersight s Behavioral Analytics service captures and analyzes customer and employee interactions, employee desktop data, and other contextual information to improve operational performance and predict future customer and employee outcomes. Mattersight s analytics are based on millions of proprietary algorithms and the application of unique behavioral models. The company s SaaS+ delivery model combines analytics in the cloud with deep customer partnerships to drive significant business value. Mattersight s applications are used by leading companies in Healthcare, Insurance, Financial Services, Telecommunications, Cable, Utilities, and Government.

Following the sale by the Company of its ICS Business Unit on May 28, 2011, the Company changed its corporate name to Mattersight Corporation and began operating in a single business segment, focused primarily on Behavioral Analytics. Through Behavioral Analytics, the Company generates two types of revenue:

(1) Managed services revenue, which is recurring, annuity revenue from long-term (generally three-to five-year) contracts and includes subscription and amortized deployment revenue; and

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

Set forth below is a more detailed description of the capabilities that the Company currently offers.

Behavioral Analytics

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

- Automatically measure customer satisfaction and agent performance on every analyzed call;
- Identify and understand customer personality;
- 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;
- Identify customer experience issues and score calls for retention risk;
- Measure and improve supervisor effectiveness and coaching;
- Improve agent effectiveness by analyzing key attributes of desktop usage;
- Predict likelihood of a customer attrition; and
- Identify fraud callers and improve authentication processes.

The Company has designed a highly-scalable, flexible, and adaptive application platform to enable the Company to implement and operate its Behavioral Analytics offerings for its clients. These offerings are primarily delivered through a SaaS+ model, as a managed subscription service from which Mattersight derives Managed services revenue and Consulting services revenue. Managed services revenue consists of deployment and subscription services and Consulting services revenue consists of post-deployment follow-on services, including coaching and training and custom data analysis.

Table of Contents

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In addition to our Behavioral Analytics offerings, Mattersight also generates revenue from the following services:

Marketing Managed Services

Marketing Managed Services revenue is derived from marketing application hosting services.

CRM Services

CRM Services revenue is derived from operational consulting services that enhance business performance through improved process efficiencies and redesign of workflows.

Types of Revenue

Managed Services Revenue

Growth in Managed services revenue is primarily driven by the execution of new Behavioral Analytics contracts, under which the Company deploys and provides the ongoing hosting of our proprietary Behavioral Analytics System. Based on each client s business requirements, the Behavioral Analytics System is configured and integrated into the client s environment and then deployed in either a remote-hosted or, in one case, an on-premise hosted environment. Thereafter, the client s selection of our Behavioral Analytics offerings is provided, on a subscription basis, for a term that is generally three to five years. The fees and costs related to the initial deployment are deferred and amortized over the term of the contract.

We also generate Managed services revenue from Marketing Managed Services, specifically, from hosted customer and campaign data management. This source of Managed services revenue is likely to diminish over time as we focus on growth through Behavioral Analytics.

Consulting Services Revenue

In addition to the Consulting services revenue generated by the Consulting services provided under our Behavioral Analytics contracts, we derive a portion of this type of revenue from CRM Services for long-standing accounts. Consulting services revenue from CRM Services is anticipated to diminish over time as demand for these services continues to decline and we focus on growth through Behavioral Analytics. We bill for Consulting services on a time-and-materials or fixed-fee basis.

Note Two Summary of Significant Accounting Policies

Fiscal Year-End

The fiscal year-end dates presented for fiscal years 2011, 2010, and 2009 are December 31, 2011, January 1, 2011, and December 26, 2009, respectively. Fiscal year 2010 consisted of fifty-three weeks instead of fifty-two weeks, which did not have a material impact on the Company s financial position or results of operations.

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 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.

Reclassifications and Revisions

The sale by the Company of its ICS Business Unit and eLoyalty registered trademark / trade name to Magellan Acquisition Sub, LLC, a Colorado limited liability company and wholly-owned subsidiary of TeleTech Holdings, Inc., a Delaware corporation, closed on May 28, 2011, and the Company changed its name from eLoyalty Corporation to Mattersight Corporation effective June 1, 2011. Therefore, the results of operations of the ICS Business Unit are reported as discontinued operations for all periods presented. Additionally, certain corporate and general costs that had historically been allocated to the ICS Business Unit were reallocated to the Company and are reflected in all periods presented. Mattersight now reports financial results on a single business segment, primarily focused on Behavioral Analytics.

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company changed the revenue classification of one contract from Other revenue to subscription revenue in the fourth quarter of 2011 to better reflect the type of services provided under this contract. Revenue for this contract has been reclassified in all historical periods. As a result, the Company reclassified $0.5 million for fiscal years 2010 and 2009, respectively, from Other revenue to Behavioral Analytics revenue. Cost of services for this contract has also been reclassified in all historical periods. As a result, the Company reclassified $0.3 million for fiscal years 2010 and 2009, respectively, from Other revenue to Behavioral Analytics revenue.

Certain leadership, recruiting, and facility management expenses that have been previously reported as Sales, marketing and development have been reclassified to General and administrative. As a result, the Company reclassified $1.7 million and $1.3 million for fiscal years 2010 and 2009, respectively, from Sales, marketing and development to General and administrative.

Certain data center expenses that have been previously reported as General and administrative have been reclassified as Cost of services. The Company believes this revised classification provided a clearer understanding of its key profit/loss drivers. As a result, the Company reclassified $2.1 million for fiscal year 2009 from General and administrative to Cost of services.

These changes did not have an impact on net income (loss).

Revenue Recognition

Continuing Operations

Behavioral Analytics Revenue

Behavioral Analytics revenue consists of Managed services revenue and Consulting services revenue.

Managed services revenue consists of planning, deployment, training, and subscription fees derived from Behavioral Analytics contracts. Planning, deployment, and training fees, which are considered to be installation fees related to long-term subscription contracts, are deferred until the installation is complete and are then recognized over the term of the applicable subscription contract. The terms of these subscription contracts generally range from three to five years. 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 term of the subscription contract. Costs in excess of the foregoing revenue amount are expensed in the period incurred.

The amount of revenue generated from subscription fees is based on a number of factors, such as the number of users to whom the Behavioral Analytics Service is provided, and/or the number of hours of calls analyzed during the relevant month of the term of the subscription contract. This revenue is recognized as the service is performed for the client.

Consulting 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. These follow-on consulting services are generally performed for the Company s clients on a fixed-fee basis. Revenue is recognized as the services are performed, with performance generally assessed on the ratio of actual hours incurred to date compared to the total estimated hours over the entire term of the contract.

Other Revenue

Other revenue consists of Marketing Managed Services revenue and CRM Services revenue.

Marketing Managed Services revenue is derived from marketing application hosting. This revenue is generally in the form of fixed monthly fees received from the Company s clients and is recognized as the services are performed for each client. Any related setup fee would be recognized over the contract period of the hosting arrangement.

CRM Services revenue consists of fees generated from the Company s operational consulting services, which are provided to the Company s clients on a time-and-materials or fixed-fee basis. The Company recognizes revenue as the services are performed for time-and-materials projects. For fixed-fee projects, revenue is recognized based on the ratio of hours incurred to date compared to the total estimated hours over the entire term of the contract.

Discontinued Operations

ICS Business Unit

Managed services revenue included in the ICS Business Unit consisted of fees generated from the Company s contact center support and monitoring services. Support and monitoring services generally were contracted for a fixed fee, and the revenue was recognized ratably over the term of the contract. Support fees that were contracted on a time-and-materials basis were recognized as the services were performed for the client.

Table of Contents

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For fixed-fee Managed services contracts, where the Company provided support for third-party software and hardware, revenue was recorded at the gross amount of the sale. If the contract did not meet the requirements for gross reporting, then Managed services revenue was recorded at the net amount of the sale.

Consulting services revenue included in the ICS Business Unit consisted of the modeling, planning, configuring, or integrating of an Internet Protocol network solution within the Company s clients contact center environments. These services were provided to clients on a time-and-materials or fixed-fee basis. For the integration of a system, the Company recognized revenue as the services were performed, with performance generally assessed on the ratio of hours incurred to date compared to the total estimated hours over the entire term of the contract. For all other consulting services, the Company recognized revenue as the services were performed for the client.

Revenue from the sale of Product, which was generated primarily from the resale of third-party software and hardware by the Company, was generally recorded at the gross amount of the sale when it was delivered to the client.

In October 2009, the Financial Accounting Standards Board (FASB) amended the accounting standards for revenue recognition to remove tangible products containing software components and non-software components that function together to deliver the product s essential functionality from the scope of industry-specific software revenue recognition guidance. In October 2009, the FASB also amended the accounting standards for multiple deliverable revenue arrangements to:

(i) provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and how the consideration should be allocated;

(ii) require an entity to allocate revenue in an arrangement using estimated selling prices (ESP) of deliverables if a vendor does not have vendor-specific objective evidence of selling price (VSOE) or third-party evidence of selling price (TPE); and

(iii) eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method.

The Company elected to adopt this accounting guidance at the beginning of its first quarter of fiscal 2011 on a prospective basis. The adoption of this guidance does not impact our revenue recognition with respect to Behavioral Analytics because the implementation services sold with our hosting service are not separated into multiple accounting units because there is no standalone fair value for these services. We recognize these services revenues over the anticipated term of the hosting services, currently the contract term. This accounting guidance does not change the units of accounting for the Company s revenue transactions or the methods used to allocate consideration to the units of accounting. The revenue recognition for each of these offerings is discussed below.

For the ICS Business Unit, the Company utilized VSOE to allocate revenue to various elements in an arrangement. We determined VSOE based on our normal pricing and discounting practices for the product or service when sold separately. In determining VSOE, we required that a substantial majority of the selling prices for a product or consulting services fall within a reasonably narrow pricing range, generally evidenced by approximately 80% of such historical standalone transactions falling within plus or minus 20% of the median selling price. For the ICS Business Unit s managed services, we established VSOE through the stated renewal approach. Previously, we were able to establish VSOE for our product and service offerings except for software. If we were not able to establish VSOE for an offering, we attempted to establish fair value by utilizing TPE. TPE is established by obtaining evidence from comparable offerings from a peer company. If the Company was unable to establish fair value using VSOE or TPE, then the Company used ESP in its allocation of revenue. To determine ESP, we applied significant judgment as we weighed a variety of factors, based on the facts and circumstances of the arrangement. These factors included internal costs, gross margin objectives, and existing portfolio pricing and discounting.

Within discontinued operations, some of our sales arrangements had multiple deliverables containing software and related software components. Such sale arrangements were subject to the accounting guidance in ASC 985-605, *Software Revenue Recognition*.

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

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

Table of Contents

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Cost of Revenue before Reimbursed Expenses, Exclusive of Depreciation and Amortization

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

Sales, Marketing and Development

Sales, marketing and development expenses consist primarily of salaries, incentive compensation, commissions, and employee benefits for business development, account management, marketing, and solution development/support personnel. The personnel costs included here are net of any labor costs directly related to the generation of revenue, which are represented in Cost of services.

General and Administrative

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

Income (Loss) Per Common Share

The per common share basic net income (loss) available to common stockholders has been computed by dividing the net income (loss) available to common stockholders for each period presented by the weighted average shares outstanding. The per common share diluted income (loss) available to common stockholders has been computed by dividing the net income (loss) available to common stockholders by the weighted average shares outstanding plus the dilutive effect of common stock equivalents, which is primarily related to 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 of Financial Instruments

The carrying values of current assets and liabilities approximated their fair values as of December 31, 2011 and January 1, 2011. 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.

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.

Restricted Cash

Restricted cash principally represents cash as security for the Company s line of credit and letters of credit issued to support the Company s capital lease obligations.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to a concentration of credit risk consist of cash and cash equivalents, restricted cash, and receivables. Cash and cash equivalents and restricted cash 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. The Company s receivables are derived from billings to clients located primarily in the U.S. and are denominated in U.S. dollars. For fiscal year 2011, there were three clients that accounted for 10% or more of total revenue. Vangent, Inc., Allstate Insurance Company, and Health Care Service Corporation accounted for 22%, 15%, and 14% of total revenue, respectively. For fiscal year 2010, there were four clients accounting for more than 10% of the total revenue. Vangent, Inc., United HealthCare Services, Inc., Health Care Service Corporation, and Allstate Insurance Company accounted for 20%, 15%, 14%, and 13% of total revenue, respectively. For fiscal year 2009, three clients accounted for 10% of total revenue. Blue Shield of California, United HealthCare Services, Inc., and Health Care Service Corporation accounted for 16%, 14%, and 11% of total revenue, respectively. As of December 31, 2011, three clients, United HealthCare Services, Inc., Allstate Insurance Company, and CVS Caremark Corporation accounted for 25%, 22%, and 14% of total gross accounts receivable, respectively. As of January 1, 2011, three clients, United HealthCare Services, Inc., Allstate Insurance Company, and Health Care Service Corporation, accounted for 28%, 19%, and 17% of total gross accounts receivable, respectively.

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 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 periodically reviewed 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 no impairment as of December 31, 2011 and January 1, 2011.

The Company accounts for software developed for internal use in accordance with the guidance provided under ASC Topic 350, 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 present value of future lease payments and depreciated on a straight line basis. All capital leases are for terms of either 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 for one or more reporting units, we perform a detailed quantitative assessment using a two-step test approach. In the first step, the fair value of each 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 to 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. In 2011, after completing our annual qualitative review, we concluded that it was not more-likely-than-not that the carrying value of any of our reporting units exceeded its fair value. Accordingly, we concluded that further quantitative analysis and testing was not required, and no goodwill impairment charge was required.

A detailed determination of the fair value of a reporting unit may be carried forward from one year to the next if specific criteria have been met.

There has been no impairment identified as a result of the annual review of goodwill as of December 31, 2011 and January 1, 2011. The carrying value of goodwill was $1.0 million as of December 31, 2011 and January 1, 2011.

Intangible Assets

Intangible assets reflect costs related to patent and trademark applications, Marketing Managed Services customer relationships acquired in 2004, and the 2003 purchase of a license for certain intellectual property. Patent and trademark applications are amortized over 120 months. The other intangible assets are fully amortized. Currently, amortization expense of intangible assets is expected to be $40 thousand annually thereafter. There was an impairment charge of $0.1 million during fiscal years 2011 and 2010.

	December 31, 2011	January 1, 2011

Gross intangible assets	$	2.8	$	2.7
Accumulated amortization of intangible assets		(2.6)		(2.4)
Total	$	0.2	$	0.3

Other Long-Term Assets

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

Table of Contents

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 does not provide U.S. deferred income taxes on earnings of U.S. or foreign subsidiaries, which are expected to be indefinitely reinvested.

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

The Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. Significant judgment is used to determine the likelihood of the benefit. There is additional guidance on derecognition, classification, interest and penalties on income taxes, accounting in interim periods, and disclosure requirements.

Intraperiod tax allocation requires that the provision for income taxes be allocated between continuing operations and other categories of earnings (such as discontinued operations or other comprehensive income) for each tax jurisdiction. In periods in which there is a year-to-date pre-tax loss from continuing operations and pre-tax income in other categories of earnings, the tax provision is first allocated to the other categories of earnings.

Short-Term Debt

Under the terms of the Settlement Agreement, the Company entered into promissory notes with TCV in the aggregate amount of $3.6 million, which accrue interest at a rate of 7% per annum and are payable December 31, 2012 (the Notes). Under the terms of the Notes, the Company is required to apply 50% of net proceeds from the issuance of equity or equity equivalents to pay down the Notes. As a result, in connection with the sale of Common Stock to IGC Fund under the terms of the Purchase Agreement, the Company applied $3.0 million to pay down the Notes, representing 50% of the net proceeds from such sale.

Stockholders Equity (Deficit)

Stockholders equity (deficit) includes Common Stock issued, additional paid-in capital, accumulated deficit, treasury stock, and accumulated other comprehensive loss. The 1.7 million shares of Series B Stock 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 (deficit) and comprehensive income (loss). Income and expense items are translated at average exchange rates prevailing during the period. Foreign currency net losses were $0.4 million for fiscal year 2011, $0.1 million for fiscal year 2010, and less than $0.1 million for fiscal year 2009. These foreign currency transactions from subsidiaries are included in interest and other income within the consolidated statements of operations.

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.

Table of Contents

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Recent Accounting Pronouncements

In October 2009, the FASB issued Accounting Standards Update (ASU) No. 2009-13, Revenue Recognition (ASC Topic 605) Multiple-Deliverable Revenue Arrangements, a consensus of the FASB Emerging Issues Task Force. This guidance modifies the fair value requirements of ASC subtopic 605-25, Revenue Recognition-Multiple Element Arrangements, by allowing the use of the best estimate of selling price in addition to VSOE and vendor objective evidence (now referred to as TPE, standing for third-party evidence) for determining the selling price of a deliverable. A vendor is now required to use its best estimate of the selling price when VSOE or TPE of the selling price cannot be determined. In addition, the residual method of allocating arrangement consideration is no longer permitted.

In October 2009, the FASB also issued ASU No. 2009-14, Software (ASC Topic 985) Certain Revenue Arrangements That Include Software Elements, a consensus of the FASB Emerging Issues Task Force. This guidance modifies the scope of ASC subtopic 965-605, Software-Revenue Recognition, to exclude from its requirements (i) non-software components of tangible products and (ii) software components of tangible products that are sold, licensed, or leased with tangible products when the software components and non-software components of the tangible product function together to deliver the tangible product s essential functionality.

ASU No. 2009-13 and ASU No. 2009-14 also required expanded qualitative and quantitative disclosures and were effective for fiscal years beginning on or after June 15, 2010. We elected to adopt these updates effective for our fiscal year beginning January 2, 2011 and have applied them prospectively from that date for new or materially modified arrangements. The adoption of this guidance did not have a material effect on the Company s consolidated financial statements.

In December 2010, the FASB issued ASU No. 2010-28, Intangibles Goodwill and Other (ASC 350), When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts ASU No. 2010-28, which modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. The adoption of ASU No. 2010-28 was effective for our fiscal year beginning January 2, 2011. The adoption of this guidance did not have a material effect on the Company s consolidated financial statements.

In June 2011, the FASB issued ASU 2011-05, Comprehensive Income (Topic 220) Presentation of Comprehensive Income, which requires an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the Statement of Shareholders Equity. The items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income were not changed. Additionally, no changes were made to the calculation and presentation of earnings per share. In December 2011, the FASB issued ASU 2011-12, which deferred the effective date of guidance pertaining to the reporting of reclassification adjustments out of accumulated other comprehensive income in ASU 2011-05. ASU 2011-12 reinstated the requirements for the presentation of reclassifications that were in place prior to the issuance of ASU 2011-05. The Company will adopt ASU 2011-05 effective for our fiscal year ending December 29, 2012 and will retrospectively apply the new presentation of comprehensive income to prior periods presented. Other than the change in presentation and disclosure, the update will not have an impact on the Company s consolidated financial statements.

In September 2011, the FASB issued ASU No. 2011-08, Intangibles Goodwill and Other (Topic 350) Testing Goodwill for Impairment, which allows an entity to use a qualitative approach to test goodwill for impairment. ASU 2011-08 permits an entity to 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. If it is concluded that a potential exposure exists, it is necessary to perform the currently prescribed two-step goodwill impairment test. Otherwise, the two-step goodwill impairment test is not required. We adopted ASU 2011-08 in connection with our annual impairment test performed in the fourth quarter of 2011. The adoption of this update did not have a material effect on the Company s consolidated financial statements.

Table of Contents

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note Three Discontinued Operations

The following table summarizes the components included within income from discontinued operations, net of tax within the Company s Consolidated Statements of Operations for the periods indicated.

	For the Fiscal Years Ended		
	2011	**2010**	**2009**
Net sales	$ 22.9	$ 57.3	$ 69.0
Total expenses	(23.7)	(52.5)	(61.4)
Gain from sale of assets	36.5		
Provision for income taxes	(6.8)	(1.8)	(2.9)
Income from discontinued operations	28.9	3.0	4.7

Intraperiod tax allocation requires that the provision for income taxes be allocated between continuing operations and other categories of earnings (such as discontinued operations or other comprehensive income) for each tax jurisdiction. In periods in which there is a year-to-date pre-tax loss from continuing operations and pre-tax income in other categories of earnings, the tax provision is first allocated to the other categories of earnings. A related tax benefit is then recorded in continuing operations. While intraperiod tax allocation in general does not change the overall tax provision, it may result in a gross-up of the individual components, thereby changing the amount of tax provision included in each category. Included in our continuing operations income tax provision is a tax benefit of $5.9 million and $1.7 million for the years ended December 31, 2011 and January 1, 2011, respectively. Included in our discontinued operations income tax provision is tax expense of $6.8 million for the year ended December 31, 2011, $1.8 million for the year ended January 1, 2011, and $2.9 million for the year ended December 26, 2009. Depending upon the level of our future earnings and losses and their impact on income from discontinued operations, it is possible that these tax adjustments may change or even reverse in future periods.

We are required to account for the income tax provision as stated in the previous paragraph, based on our 2011 results for continuing operations, our estimated 2011 tax liability was $0.5 million.

Note Four Severance and Related Costs

Severance costs are comprised primarily of contractual salary and related fringe benefits over the severance payment period. Facility costs include losses on contractual lease commitments, net of estimated sublease recoveries, and impairment of leasehold improvements and certain office assets.

Continuing Operations

For fiscal year 2011, the Company recorded $0.3 million of income for continuing operations related to the favorable renegotiation of an office lease, partially offset by the severance and related costs for the elimination of one position and an office consolidation. For fiscal year 2010, the Company recorded $0.5 million of expense for continuing operations related to severance and related costs for the elimination of 26 positions and an adjustment to sublease recoveries. For fiscal year 2009, the Company recorded $1.0 million of expense for continuing operations related to severance and related costs for the elimination of 19 positions.

For the fiscal year ended January 1, 2011, the Company made cash payments of $0.6 million related to cost-reduction actions for continuing operations. For the fiscal year ended December 26, 2009, the Company made cash payments of $1.1 million related to cost-reduction actions for continuing operations. The cash payments in fiscal years 2011, 2010, and 2009 were primarily related to severance and related costs, office space reductions, and office closures.

Table of Contents

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The severance and related costs and their utilization for the fiscal years ended 2009, 2010, and 2011 are as follows:

	Employee Severance	Facilities	Total
Balance, December 27, 2008	$ 0.1	$ 0.4	$ 0.5
Charges	0.9		0.9
Adjustments		0.1	0.1
Charged to severance and related costs	0.9	0.1	1.0
Payments	(1.0)	(0.1)	(1.1)
Balance, December 26, 2009	$	$ 0.4	$ 0.4
Charges	0.5		0.5
Adjustments			
Charged to severance and related costs	0.5		0.5
Payments	(0.5)	(0.1)	(0.6)
Balance, January 1, 2011	$	$ 0.3	$ 0.3
Charges		(0.1)	(0.1)
Adjustments		(0.2)	(0.2)
Charged to severance and related costs		(0.3)	(0.3)
Payments			
Balance, December 31, 2011	$	$	$

As of December 31, 2011, $46 thousand remained reserved for continuing operations relating to an office consolidation. The $46 thousand balance is in Other current liabilities .

Discontinued Operations

During fiscal years 2011, 2010, and 2009, the Company recognized pre-tax charges (including adjustments) of $0.2 million, $0.7 million, and $0.4 million, respectively. For the year ended 2011, the Company recorded $0.2 million of expense related to severance and related costs of discontinued operations for the elimination of 11 positions. For the year ended 2010, the Company recorded $0.7 million of expense related to severance and related costs of discontinued operations for the elimination of 37 positions. For the year ended 2009, the Company recorded $0.4 million of expense related to severance and related costs of discontinued operations for the elimination of 15 positions.

During fiscal years 2011, 2010, and 2009, the Company made cash payments of $0.2 million, $0.7 million, and $0.4 million, respectively, related to cost-reduction actions for discontinued operations. The cash payments made during fiscal years 2011, 2010, and 2009 were related to severance and related costs.

The severance and related costs and their utilization for the fiscal years ended 2009, 2010, and 2011 are as follows:

	Employee Severance	Facilities	Total
Balance, December 27, 2008	$	$	$
Charges	0.4		0.4
Adjustments			
Charged to severance and related costs	0.4		0.4
Payments	(0.4)		(0.4)
Balance, December 26, 2009	$	$	$
Charges	0.7		0.7
Adjustments			
Charged to severance and related costs	0.7		0.7
Payments	(0.7)		(0.7)
Balance, January 1, 2011	$	$	$
Charges	0.2		0.2
Adjustments			
Charged to severance and related costs	0.2		0.2
Payments	(0.2)		(0.2)
Balance, December 31, 2011	$	$	$

As of December 31, 2011, all severance and related costs for discontinued operations have been paid.

Table of Contents

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note Five Receivables, Net

Receivables consist of the following:

	As of	
	December 31, 2011	January 1, 2011
Amounts billed to clients	$ 1.4	$ 1.7
Unbilled revenue	1.1	0.3
	2.5	2.0
Allowances for doubtful accounts		
Receivables, net	$ 2.5	$ 2.0

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, 2011 and January 1, 2011 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 our clients were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Note Six Current Prepaid Expenses

Current prepaid expenses were $5.3 million and $4.3 million as of December 31, 2011 and January 1, 2011, respectively. Current prepaid expenses primarily consist of deferred costs and prepaid commissions related to Behavioral Analytics. These costs are recognized over the contract terms of the respective agreements, generally three to five years. Costs included in current prepaid expenses will be recognized within the next twelve months. Current prepaid expenses consisted of the following:

	As of	
	December 31, 2011	January 1, 2011
Behavioral Analytics deferred costs	$ 2.5	$ 1.8
Prepaid commissions	2.0	1.2
Other	0.8	1.3
Total	$ 5.3	$ 4.3

Note Seven Equipment and Leasehold Improvements

Equipment and leasehold improvements consist of the following:

	As of	
	December 31, 2011	January 1, 2011
Computers and software	$ 29.2	$ 31.7
Furniture and equipment	0.5	0.8
Leasehold improvements	0.5	1.4
Equipment and leasehold improvements, gross	30.2	33.9
Accumulated depreciation and amortization	(25.9)	(29.5)
Equipment and leasehold improvements, net	$ 4.3	$ 4.4

Depreciation expense was $3.2 million, $3.3 million, and $3.8 million, for fiscal years 2011, 2010, and 2009, respectively. Assets acquired under capital leases were $2.5 million, $1.4 million, and $0.8 million in fiscal years 2011, 2010, and 2009, respectively. Depreciation expense on capital lease assets was $1.8 million, $1.5 million, and $1.3 million in fiscal years 2011, 2010, and 2009, respectively.

Note Eight Income Taxes

Income (loss) before income taxes consisted of the following:

	For the Fiscal Years Ended		
	2011	2010	2009
United States	$ (15.8)	$ (16.6)	$ (16.9)
Foreign	(0.6)	(1.4)	(1.3)
Total	$ (16.4)	$ (18.0)	$ (18.2)

Table of Contents

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

	For the Fiscal Years Ended		
	2011	**2010**	**2009**
Current:			
Federal	$ 5.5	$ 1.6	$ 2.6
State	0.4	0.1	0.2
Foreign			
Total current	5.9	1.7	2.8
Deferred:			
Federal			
State			
Foreign			
Total deferred			
Income tax benefit (provision)	$ 5.9	$ 1.7	$ 2.8

The 2011 earnings and gain from discontinued operations include $6.8 million of tax expense.

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

	For the Fiscal Years Ended		
	2011	**2010**	**2009**
Federal tax benefit, at statutory rate	$ 5.7	$ 6.3	$ 6.4
State tax benefit, net of federal benefit	0.4	0.1	0.2
Nondeductible expenses	(0.2)		
Valuation allowance		(4.7)	(3.8)
Income tax benefit (provision)	$ 5.9	$ 1.7	$ 2.8

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

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

For the Fiscal Years Ended

	2011	2010	2009
Balance at beginning of year	$ 12.8	$ 12.8	$ 12.8
Additions based on tax positions related to the current year	0.3		
Additions for tax positions of prior years			
Reductions for tax positions of prior years	(0.2)		
Reductions for tax positions as a result of lapse of statute			
Settlements			
Balance at end of year	$ 12.9	$ 12.8	$ 12.8

Due to the Company s worldwide net operating loss carryforward position, all but $0.3 million of 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 worldwide net operating loss carryforward position, accrued interest and penalties associated with uncertain tax positions as of December 31, 2011 are not material. Interest and penalties associated with uncertain tax positions are recorded as part of income tax expense.

Table of Contents

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The statutes of limitation for the Company s income tax returns after 2001 effectively remain open for examination by the Internal Revenue Service (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. In 2011, an audit of fiscal years 2008 and 2009 was completed by the IRS. This audit resulted in a reduction of our net operating loss carryforward from these years and no tax liability. This reduction is reflected in this tax footnote.

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 were comprised of the following:

	As of	
	December 31, 2011	**January 1, 2011**
Deferred tax assets:		
Net operating loss carryforwards	$ 52.1	$ 64.9
Receivable allowances		
Other accruals	4.6	3.5
Depreciation and amortization, including goodwill	1.0	2.1
Non-deductible reserves		
Tax credit carryforward	0.8	0.5
Valuation allowance	(55.8)	(62.7)
Total deferred tax assets	2.7	8.3
Deferred tax liabilities:		
Prepaid expenses	(2.8)	(8.3)
Total deferred tax liabilities	(2.8)	(8.3)
Net deferred tax asset (liability)	$ (0.1)	$

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, 2011 and January 1, 2011.

Intraperiod tax allocation requires that the provision for income taxes be allocated between continuing operations and other categories of earnings (such as discontinued operations or other comprehensive income) for each tax jurisdiction. In periods in which there is a year-to-date pre-tax loss from continuing operations and pre-tax income in other categories of earnings, the tax provision is first allocated to the other categories of earnings. A related tax benefit is then recorded in continuing operations. While intraperiod tax allocation in general does not change the overall tax provision, it may result in a gross-up of the individual components, thereby changing the amount of tax provision included in each category. Included in our continuing operations income tax provision is a tax benefit of $5.9 million for the year ended December 31, 2011 and $1.7 million for the year ended January 1, 2011. Included in our discontinued operations income tax provision is tax expense of $6.8 million for the year ended December 31, 2011 and $1.8 million for the year ended January 1, 2011.

During fiscal year 2002, the Company established a valuation allowance related to deferred tax assets for the U.S. This is 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, 2011, net deferred tax assets of $55.8 million were fully offset by a valuation allowance. The Company s U.S. Federal net operating losses (NOLs) of $177.9 million and U.S. State NOLs of $101.5 million will expire beginning in 2022 and 2012, respectively. The Company s non-U.S. NOLs of $0.6 million are subject to various expiration dates beginning in 2012. The Company also carries $0.5 million in Research and Development credit carryforwards that will expire beginning in 2021 and a U.S. Federal Alternative Minimum Tax credit carryforward of $0.3 million that does not expire.

Table of Contents

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 a limitation on the use of NOL s under Section 382. 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 Nine Other Long-Term Assets

Other long-term assets were $4.7 million as of December 31, 2011 and $3.6 million as of January 1, 2011. Other long-term assets primarily consist of deferred costs and prepaid commissions related to Behavioral Analytics. These costs are recognized over the terms of the respective agreements, generally three to five years. Costs included in long-term assets will be recognized over the remaining term of the agreements beyond the first twelve months. Other long-term assets consisted of the following:

	As of	
	December 31, 2011	**January 1, 2011**
Behavioral Analytics deferred costs	$ 2.4	$ 2.1
Prepaid commissions	2.2	1.2
Other	0.1	0.3
Total	$ 4.7	$ 3.6

Note Ten Short-Term Debt

Under the terms of the Settlement Agreement, the Company entered into promissory notes with TCV in the aggregate amount of $3.6 million, which accrue interest at a rate of 7% per annum and are payable December 31, 2012 (the Notes). Under the terms of the Notes, the Company is required to apply 50% of net proceeds from the issuance of equity or equity equivalents to pay down the Notes. As a result, in connection with the sale of Common Stock to IGC Fund under the terms of the Purchase Agreement, the Company applied $3.0 million to pay down the Notes, representing 50% of the net proceeds from such sale.

Note Eleven Line of Credit

The Company maintains a Loan Agreement with the Bank, which expires on December 31, 2012. The Facility, which is $5.0 million as of December 31, 2011, requires the Company to maintain a minimum cash and cash equivalent balance within a secured account at the Bank. The balance in the secured account cannot be less than the outstanding balance drawn on the Facility line of credit and letter of credit obligations under the Facility. Available credit under the Facility has been reduced by $1.5 million related to letters of credit issued under the Facility to support the Company s capital lease obligations. As a result, $3.5 million remains available under the Facility as of December 31, 2011. Loans under the Facility bear interest at the Bank s prime rate or, at the Company s election, an alternate rate of LIBOR (London InterBank Offering Rate) plus 0.75%. The Company did not have any borrowings or interest expense under the Facility during fiscal years 2011 or 2010.

Note Twelve Employee Benefit Plans

The Company s U.S. employees are eligible to participate in the Mattersight Corporation 401(k) Plan (the 401(k) Plan) on the first day of the month coinciding with or following their date of hire. The 401(k) 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. In order to conserve cash given the then-current macro-economic uncertainties, Mattersight suspended the employer matching contributions for both U.S. and non-U.S. plans, fully for fiscal years 2011 and 2010 and partially for fiscal year 2009. For fiscal year ended 2009, a partial year employer match contribution of $0.2 million was expensed. The Company funds non-U.S. contributory plans as required by statutory regulations. Amounts funded by the Company were immaterial for non-U.S. plans for the periods presented.

Note Thirteen Capital Stock and Series B Stock

The Company s authorized capital stock consists of (i) 50,000,000 shares of Common Stock, par value $0.01 per share, and (ii) 40,000,000 shares of preferred stock, par value $0.01 per share. The Company has designated 5,000,000 shares of its preferred stock as its Series B Stock, of which 1,670,696 and 3,549,078 shares were issued and outstanding as of December 31, 2011 and January 1, 2011, respectively.

Table of Contents

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

On December 20, 2011, Mattersight repurchased 1,872,805 shares of Series B Stock under the terms of the Settlement Agreement with TCV, to settle arbitration relating to the parties dispute regarding whether the sale of the ICS Business Unit triggered immediate payment of the liquidation preference under the Certificate of Designations for the Series B Stock.

On September 12, 2008, Mattersight completed a Rights Offering, which raised $14.8 million, net of expenses. Under the terms of the Rights Offering, persons who owned shares of Common Stock or Series B Stock as of the close of business on August 13, 2008 (the record date for the Rights Offering) received the right to purchase 0.19756 shares of Common Stock. These subscription rights expired on September 12, 2008. Pursuant to the terms of the Rights Offering, the Company issued 2,645,395 shares of Common Stock at $5.67 per share.

In December 2006, the Company completed an $18.0 million Rights Offering. Under terms of the Rights Offering, persons who owned shares of Common Stock or Series B Stock as of the close of business on November 20, 2006 (the record date for the Rights Offering) received the right to purchase 0.0910 shares of Common Stock. These subscription rights expired on December 15, 2006. Pursuant to the terms of the Rights Offering, the Company issued 1,001,342 shares of Common Stock at $17.97 per share.

In December 2001, at the time of issuance of the Series B Stock, a beneficial conversion adjustment was calculated (since the fair market value of a share of Common Stock at the time exceeded the purchase price of a share of Series B Stock) aggregating $4.0 million. The Series B Stock was recorded at the date of issuance net of issuance costs and the beneficial conversion adjustment. The discount attributable to the issuance costs was fully accreted on the date of issuance by charging additional paid-in capital and increasing the recorded amount of Series B Stock. The Series B Stock was accreted to its full redemption value of $23.3 million on a straight line basis from the date of issuance to June 19, 2002 by charging additional paid-in capital $0.7 million per month and increasing the recorded amount of Series B Stock by a like amount.

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 Fourteen Stock-Based Compensation

Historically, the Company issued stock awards under two stock incentive plans: the Mattersight Corporation 1999 Stock Incentive Plan (the 1999 Plan) and the Mattersight Corporation 2000 Stock Incentive Plan (the 2000 Plan). However, the 2000 Plan expired in accordance with its terms on September 23, 2011, ten years after the effective date of the last amendment and restatement thereof, and no further awards have been issued thereunder. 20,620 treasury shares, representing all authorized and unissued treasury shares under the 2000 Plan were cancelled at that time.

Under the 1999 Plan, awards of restricted stock, installment stock, salary replacement, 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 plan. Under the 1999 Plan, on the first day of each fiscal 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. As of December 31, 2011, there were a total of 897,513 shares available for future grants under the 1999 Plan and from treasury stock.

Stock-based compensation expense was $5.4 million, $4.4 million, and $4.8 million for fiscal years ended 2011, 2010, and 2009, respectively. The Company recognizes stock compensation expense on a straight-line basis over the vesting period. The Company has established its forfeiture rate based on historical experience. 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. The amount of this excess tax deduction was $0 for each of fiscal years ended December 31, 2011 and January 1, 2011.

Restricted Stock

Restricted stock awards are shares of Mattersight Common Stock granted to an individual. During the restriction 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. Installment stock awards are grants to an individual of a contractual right to receive future shares of Mattersight Common Stock in specified amounts on specified vesting dates, subject to the individual remaining a Mattersight employee on the specified vesting dates. The holder has no benefits of ownership in installment stock until such time as the installment stock actually vests. The Company recognized compensation expense related to restricted stock awards of $4.8 million, $3.1 million, and $3.0 million for the fiscal years ended 2011, 2010, and 2009, respectively.

Table of Contents

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Restricted and installment stock award activity was as follows for the years ended December 26, 2009, January 1, 2011, and December 31, 2011:

	Shares	Weighted Average Price
Nonvested balance at December 27, 2008	904,144	$ 11.63
Granted	600,000	$ 3.45
Vested	(489,247)	$ 10.76
Forfeited	(29,689)	$ 9.80
Nonvested balance at December 26, 2009	985,208	$ 7.14
Granted	570,100	$ 6.03
Vested	(624,073)	$ 7.43
Forfeited	(28,195)	$ 10.89
Nonvested balance at January 1, 2011	903,040	$ 6.12
Granted	1,246,955	$ 6.58
Vested	(737,880)	$ 7.04
Forfeited	(126,002)	$ 6.51
Nonvested balance at December 31, 2011	1,286,113	$ 6.33

	For the Fiscal Years Ended		
	2011	2010	2009
Total fair value of restricted and installment stock awards vested	$ 4.8	$ 3.6	$ 2.7

Following the completion of the sale of the ICS Business Unit on May 28, 2011, 21,278 unvested restricted stock awards and 8,750 stock options held by the employees of the ICS Business Unit were cancelled pursuant to the terms of the respective Restricted Stock Award and Stock Option Agreements.

As of December 31, 2011, there remains $5.7 million of unrecognized compensation expense related to restricted and installment stock awards. These costs are expected to be recognized over a weighted average period of 1.9 years.

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. The Company recognized compensation expense related to option awards of $0.5 million, $1.1 million, and $1.1 million for the fiscal years ended 2011, 2010, and 2009, respectively.

In addition, the 1999 Plan provides that each non-employee director, upon commencing service, shall receive a non-qualified stock option to purchase 50,000 shares of Common Stock that vests ratably over a period of 48 months. The day after the annual stockholders meeting, each non-employee director is granted a non-qualified stock option to purchase 5,000 shares of Common Stock. 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.

During fiscal year 2011, options to purchase from the Company a total of 130,000 shares of Common Stock were granted. On May 20, 2011, each of the six then-current non-employee directors received an option to purchase from the Company 5,000 shares of Common Stock. The options will vest 25% on May 31, 2012 and the balance will vest ratably over the following 12 quarters, with a maximum term of 10 years. The exercise price per share was $6.27, the closing price of a share of Common Stock on the grant date. Then, pursuant to the terms of the Second Amended and Restated Executive Employment Agreement between Kelly D. Conway and the Company dated April 19, 2011, Mr. Conway was granted an option to purchase from the Company 50,000 shares of Common Stock on June 6, 2011, in connection with the close of the sale of the ICS Business Unit. The options will vest 25% on May 31, 2012 and the balance will vest ratably over the following 12 quarters, with a maximum term of 10 years. The exercise price per share was $6.15, the closing price of a share of Common Stock on the grant date. Lastly, on December 20, 2011, the Board of Directors increased the size of the Board by adding an additional non-employee member, Phillip R. Dur. In connection with his Board appointment, Mr. Dur received an option to purchase 50,000 shares of Common Stock, vesting ratably over 48 months, with a maximum term of 10 years. The exercise price per share was $4.89, the closing price of a share of Common Stock on the grant date.

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

During fiscal year 2010, a total of 30,000 options were granted to non-employee directors. Each of the six then-current non-employee directors received an option to purchase 5,000 shares of Common Stock that vested 25% on May 31, 2011; the balance vests quarterly over the following three years, with a maximum term of 10 years. The exercise price per share was $6.34, the closing price of a share of Common Stock on the grant date.

During fiscal year 2009, options to purchase a total of 326,000 shares of Common Stock were granted to non-employee directors. On February 18, 2009, each of the five then-current non-employee directors received options to purchase 50,000 shares of Common Stock, vesting in 16 equal quarterly installments, with a maximum term of 10 years. The exercise price per share was $4.25, the closing price of a share of Common Stock on February 18, 2009. Then on March 2, 2009, the Board of Directors resolved to increase the size of the Board by adding an additional non-employee member, appointing David B. Mullen. In connection with his Board appointment, Mr. Mullen received an option to purchase 50,000 shares of Common Stock, vesting ratably over 48 months, with a maximum term of 10 years. The exercise price per share was $4.88, the closing price of a share of Common Stock on March 2, 2009. Lastly, on May 15, 2009, each of the six then-current non-employee directors, with the exception of Mr. Mullen, received an option to purchase 5,000 shares of Common Stock that vested 25% on May 31, 2010; with the balance vesting quarterly over the following three years, with a maximum term of 10 years. Based on his Board appointment date, Mr. Mullen received an option to purchase 1,000 shares of Common Stock. The exercise price per share for all of these May 31, 2010 options was $6.90, the closing price of a share of Common Stock on the grant date.

Option activity was as follows for the years ended December 26, 2009, January 1, 2011, and December 31, 2011:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Weighted Average Fair Value of Option Grants
Outstanding as of December 27, 2008	934,402	$ 17.45	6.1	
Exercisable as of December 27, 2008	587,527	$ 19.52		
Granted	326,000	$ 4.56		$ 2.78
Exercised	(1,000)	$ 3.25		
Forfeited	(28,197)	$ 38.07		
Outstanding as of December 26, 2009	1,231,205	$ 13.57	6.4	
Exercisable as of December 26, 2009	783,542	$ 16.47		
Outstanding intrinsic value at December 26, 2009	$ 1.4			
Exercisable intrinsic value at December 26, 2009	$ 0.8			
Granted	30,000	$ 6.34		$ 3.92
Exercised	(895)	$ 2.73		
Forfeited	(7,918)	$ 176.96		
Outstanding as of January 1, 2011	1,252,392	$ 12.37	5.5	

Exercisable as of January 1, 2011	976,562	$ 14.05		
Outstanding intrinsic value at January 1, 2011	$ 1.1			
Exercisable intrinsic value at January 1, 2011	$ 0.8			
Granted	130,000	$ 5.69		$ 3.44
Exercised		$		
Forfeited	(154,457)	$ 18.07		
Outstanding as of December 31, 2011	1,227,935	$ 10.95	5.4	
Exercisable as of December 31, 2011	986,626	$ 12.30		
Outstanding intrinsic value at December 31, 2011	$ 0.3			
Exercisable intrinsic value at December 31, 2011	$ 0.2			

29

Table of Contents

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	For the Fiscal Years Ended		
	2011	**2010**	**2009**
Total fair value of stock options vested	$ 0.6	$ 1.2	$ 1.4
Intrinsic value of stock options exercised			
Proceeds received from option exercises			

As of December 31, 2011, there remains $0.7 million of unrecognized compensation expense related to stock options. These costs are expected to be recognized over a weighted average period of 1.8 years.

The fair value for options granted during fiscal years 2011, 2010, and 2009 was estimated on the date of grant using a Black Scholes option-pricing model. The Company used the following assumptions:

	For the Fiscal Years Ended		
	2011	**2010**	**2009**
Risk-free interest rates	0.9%	1.8%	1.8%
Expected dividend yield			
Expected volatility	67%	68%	67%
Expected lives	6.0 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.

Other Stock Compensation

ICS Performance Unit Awards

On November 3, 2009, the Compensation Committee approved the grant of performance unit awards to certain employees of the ICS Business Unit. The performance period for the awards began on October 1, 2009 and ended on the date of the sale of the ICS Business Unit, which constituted an acceleration event under the terms of the award agreement. As required by the award agreement, to determine the value of the performance units and the payout with respect thereto, Mattersight s Compensation Committee evaluated the ultimate value of the ICS Business Unit arising from its sale (Business Unit Value) relative to the baseline value as defined in the award agreement. The Compensation Committee determined, after due consideration, that the sale did not result in Business Unit Value in excess of the baseline value and that, therefore, there will be no payout with respect to the performance units. As a result, for fiscal year 2011, the Company reversed $0.4 million of expense previously recorded for this program. During fiscal years 2010 and 2009, the Company had expensed $0.2 million and $0.2 million, respectively, for this program.

Employee Stock Purchase Plan

The Employee Stock Purchase Plan (the ESPP) is intended to qualify as an employee stock purchase plan under section 423 of the Internal Revenue Code. Under the ESPP, eligible employees are permitted to purchase shares of Mattersight 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. A total of 29,554 shares and 39,048 shares were issued under the ESPP during fiscal years 2011 and 2010, respectively. The Company recorded $39 thousand, $41 thousand, and $65 thousand of expense for the ESPP during fiscal years 2011, 2010, and 2009, respectively.

Note Fifteen Income (Loss) Per Share

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

	For the Fiscal Years Ended		
	2011	2010	2009
Loss from continuing operations	$ (10.6)	$ (16.3)	$ (15.3)
Series B Stock fair value over stated value	(6.5)		
Series B Stock dividends[1]	(1.2)	(1.3)	(1.3)
Loss from continuing operations available to common stockholders	(18.3)	(17.6)	(16.6)
Income from discontinued operations	28.9	3.0	4.7
Net income (loss) available to common stockholders	$ 10.6	$ (14.6)	$ (11.9)

Table of Contents

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	For the Fiscal Years Ended		
	2011	2010	2009
Per common share			
Basic/diluted loss from continuing operations, as restated(3)	$ (1.29)	$ (1.28)	$ (1.26)
Basic/diluted income from discontinued operations	$ 2.03	$ 0.22	$ 0.36
Basic/diluted net income (loss) available to common stockholders	$ 0.74	$ (1.06)	$ (0.90)
Weighted average shares outstanding (basic and diluted) (in millions)	14.23	13.70	13.26
Currently anti-dilutive common stock equivalents(2) (in millions)	3.25	4.00	4.23

(1) The Company s Board of Directors declared a cash dividend of $0.1785 per share on the Series B Stock, for the dividend periods January 1, 2011 through June 30, 2011, July 1, 2010 through December 31, 2010, and July 1, 2008 through December 31, 2008. The dividend payment of $1.9 million was paid on July 1, 2011. In addition, under the terms of the Settlement Agreement, the Company paid $0.3 million to TCV, representing accrued and unpaid dividends on the Series B Stock.

(2) In periods in which there was a loss, the dilutive 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 they were antidilutive.

(3) The effects of the correction of the error reported in Note Twenty-Two Restatement Basic and Diluted Loss Per Share from Continuing Operations of the Notes to Consolidated Financial Statements included in Part II Item 8 of this Form 10-K/A are reflected in all periods presented.

Note Sixteen Segments

The Company operated in two business segments, the Behavioral Analytics Service Business Unit and the ICS Business Unit, until May 28, 2011, the date of the close of the sale of the ICS Business Unit, at which point the Company began operating in a single business segment, focused primarily on Behavioral Analytics.

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 s or liability s classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

The following table provides the assets and liabilities carried at fair value measured on a recurring basis as of December 31, 2011 and January 1, 2011:

	Fair Value Measurements at December 31, 2011 Using			
	Total carrying value at December 31, 2011	Quoted Prices in Active Markets (Level 1)	Other Observable (Level 2)	Significant Unobservable (Level 3)

Money market fund	$ 18.8	$ 18.8	$	$

	Fair Value Measurements at January 1, 2011 Using			
	Total carrying value at January 1, 2011	Quoted Prices in Active Markets (Level 1)	Other Observable (Level 2)	Significant Unobservable (Level 3)
Money market fund	$ 15.8	$ 15.8	$	$

Note Eighteen Fair Value of Financial Instruments

The carrying values of current assets and liabilities approximated their fair values as of December 31, 2011 and January 1, 2011. The Company considers all highly liquid investments readily convertible into known amounts of cash (with purchased maturities of three months or less) to be cash equivalents.

Table of Contents

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note Nineteen Leases

Capital Leases

The Company acquired $2.5 million and $1.4 million of computer equipment and leasehold improvements using capital leases during fiscal years 2011 and 2010, respectively. These assets were related primarily to investments in the Company s Behavioral Analytics service. There was $1.8 million, $1.5 million, and $1.3 million of depreciation on capital leases during 2011, 2010, and 2009 respectively. All capital leases are for a term of either thirty or thirty-six months. The liabilities for these capital leases are included in Other current liabilities and Other long-term liabilities on the balance sheet. The Company expects capital investments to increase between $4.0 million to $5.0 million for fiscal year 2012 and plans on funding approximately $3.2 million to $4.2 million of these purchases with capital leases.

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, 2011:

Year	Amount
2012	$ 2.0
2013	1.2
2014	
Thereafter	
Total minimum lease payments	$ 3.2
Less: estimated executory costs	(0.2)
Net minimum lease payments	$ 3.0
Less: amount representing interest	(0.2)
Present value of minimum lease payments	$ 2.8

Capital leases included in equipment and leasehold improvements (see Note Seven):

	As of December 31, 2011	As of January 1, 2011
Computers and software	$ 5.7	$ 4.9
Accumulated depreciation and amortization	(2.8)	(2.7)
Computers and software, net	$ 2.9	$ 2.2

Capital leases consisted of the following:

As of

	December 31, 2011	January 1, 2011
Other current liabilities	$ 1.7	$ 1.3
Other long-term liabilities	1.1	0.9
Total	$ 2.8	$ 2.2

Operating Leases

The Company leases various office facilities under leases expiring at various dates through February 28, 2015. Additionally, the Company leases various property and office equipment under operating leases, generally under three year terms, expiring at various dates. Rental expense for all operating leases approximated $1.1 million, $1.2 million, and $1.3 million, for fiscal years ended 2011, 2010, and 2009, respectively. These amounts exclude rental payments related to office space reductions, which were $0.1 million, $0.1 million, and $0.1 million in fiscal years 2011, 2010, and 2009, respectively.

Table of Contents

MATTERSIGHT CORPORATION

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:

Year	Amount
2012	$ 0.5
2013	0.3
2014	0.3
2015	0.3
2016	0.2
Thereafter	0.1
Total minimum payments required	$ 1.7

Note Twenty Litigation and Other Contingencies

The Company is a party to various agreements, including substantially all major services agreements, 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 software and other deliverables provided by the Company in the course of providing services to its clients. 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 and dispute resolution procedures specified in the particular agreement. Historically, the Company has not been obligated to pay any claim for indemnification under its agreements and management is not aware of future indemnification payments that it would be obligated to make.

Under its By-Laws, subject to certain exceptions, the Company has agreed to indemnify its officers and directors for certain events or occurrences while the officer or director is, or was, serving at its request in such capacity or in certain related capacities. The Company has separate indemnification agreements with each of its directors and 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 future amounts paid. As a result of its insurance policy coverage, the Company believes the estimated fair value of these indemnification agreements is minimal. The Company has no liabilities recorded for these agreements as of December 31, 2011.

Note Twenty-One Quarterly Data (Unaudited)

	For the Fiscal Year Ended 2011				
	1st	2nd	3rd	4th	Year
Total revenue	$ 6.6	$ 6.7	$ 7.1	$ 8.7	$ 29.1
Gross margin	$ 3.4	$ 3.5	$ 3.8	$ 4.9	$ 15.6
Operating loss	$ (4.9)[1]	$ (4.3)[1]	$ (4.3)[1]	$ (3.1)[1]	$ (16.6)[1]
Loss from continuing operations	$ (4.7)[1]	$ (0.8)[1]	$ (2.5)[1]	$ (2.6)[1]	$ (10.6)[1]
Income (loss) from discontinued operations	$ 0.1	$ 28.1	$ (0.5)	$ 1.2	$ 28.9
Net (loss) income	$ (4.6)[1]	$ 27.3[1]	$ (3.0)[1]	$ (1.3)[1]	$ 18.4[1]
Net (loss) income available to common stockholders	$ (4.9)[1]	$ 27.0[1]	$ (3.3)[1]	$ (8.2)[1]	$ 10.6[1]
Basic loss from continuing operations per share, as restated[4]	$ (0.36)	$ (0.08)	$ (0.20)	$ (0.64)	$ (1.29)
Basic income (loss) from discontinued operations per share	$ 0.01	$ 1.99	$ (0.03)	$ 0.08	$ 2.03

Basic net (loss) income per share available to common stockholders	$ (0.36)	$ 1.91	$ (0.23)	$ (0.56)	$ 0.74
Diluted loss from continuing operations per share, as restated[4]	$ (0.36)	$ (0.08)	$ (0.20)	$ (0.64)	$ (1.29)
Diluted income (loss) from discontinued operations per share	$ 0.01	$ 1.99	$ (0.03)	$ 0.08	$ 2.03
Diluted net (loss) income per share available to common stockholders	$ (0.36)	$ 1.91	$ (0.23)	$ (0.56)	$ 0.74
Shares used to calculate basic and diluted net (loss) income per share (in millions)	13.95	14.11	14.30	14.54	14.23

33

Table of Contents

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	For the Fiscal Year Ended 2010				
	1st	2nd	3rd	4th	Year
Total revenue	$ 8.2	$ 7.3	$ 7.6	$ 7.8	$ 30.9
Gross margin	$ 3.6	$ 3.4	$ 3.8	$ 4.0	$ 14.8
Operating loss	$ (4.7)(3)	$ (4.8)(3)	$ (4.4)(3)	$ (4.0)(3)	$ (17.9)(3)
Loss from continuing operations	$ (4.8)(3)	$ (4.5)(3)	$ (3.8)(3)	$ (3.2)(3)	$ (16.3)(3)
(Loss) income on discontinued operations	$ (0.3)(2)	$ 0.8	$ 1.1	$ 1.4	$ 3.0(2)
Net loss	$ (5.0)(3)	$ (3.7)(3)	$ (2.8)(3)	$ (1.8)(3)	$ (13.3)(3)
Net loss available to common stockholders	$ (5.4)(3)	$ (4.0)(3)	$ (3.1)(3)	$ (2.1)(3)	$ (14.6)(3)
Basic loss from continuing operations per share, as restated(4)	$ (0.38)	$ (0.35)	$ (0.30)	$ (0.25)	$ (1.28)
Basic (loss) income from discontinued operations per share	$ (0.02)	$ 0.06	$ 0.08	$ 0.10	$ 0.22
Basic net loss per share available to common stockholders	$ (0.40)	$ (0.30)	$ (0.22)	$ (0.15)	$ (1.06)
Diluted loss from continuing operations per share, as restated(4)	$ (0.38)	$ (0.35)	$ (0.30)	$ (0.25)	$ (1.28)
Diluted (loss) income from discontinued operations per share	$ (0.02)	$ 0.06	$ 0.08	$ 0.10	$ 0.22
Diluted net loss per share available to common stockholders	$ (0.40)	$ (0.30)	$ (0.22)	$ (0.15)	$ (1.06)
Shares used to calculate basic and diluted net loss per share (in millions)	13.46	13.69	13.78	13.87	13.70

(1) Includes $4 thousand of expense, $0.4 million of income, $0.1 million of expense, $40 thousand of expense, for the first, second, third, and fourth quarters of fiscal year 2011, respectively, and $0.3 million of income for fiscal year 2011 primarily related to the favorable renegotiation of an office lease and severance and related costs associated with cost reduction plans.

(2) Includes $0.1 million for fiscal year 2010 related to the sale of a subsidiary in Switzerland.

(3) Includes $0.1 million, $0.1 million, $0.1 million, $0.2 million and $0.5 million of expense related to severance and related costs for the first, second, third, and fourth quarters of fiscal year 2010, and fiscal year 2010, respectively associated with cost reduction plans and an adjustment to sublease recoveries.

(4) The effects of the correction of the error reported in Note Twenty-Two Restatement Basic and Diluted Loss Per Share from Continuing Operations of the Notes to Consolidated Financial Statements included in Part II Item 8 of this Form 10-K/A are reflected in all periods presented.

Note Twenty-Two Restatement Basic and Diluted Loss Per Share from Continuing Operations

During the second quarter of 2012, the Company identified an error relating to its calculation of basic and diluted loss per share from continuing operations in its previously issued financial statements. As described in Note Thirteen, the Company has paid periodic dividends on the Series B Stock and in 2011 repurchased certain shares of Series B Stock. Although the Company accounted for the dividends and repurchase in its consolidated financial statements, it did not deduct the dividends or in 2011, the amounts paid in excess of liquidation value in connection with the repurchase of certain shares of Series B Stock, when calculating basic and diluted loss per share from continuing operations. The error occurred in 2011, 2010, and 2009, affecting the annual periods and all quarterly periods within these years.

To correct this error, the Company has restated its previously issued Consolidated Statements of Operations for fiscal years 2011, 2010, and 2009. In accordance with Accounting Standards Codification 260, *Earnings Per Share* , the restatement deducts from such amounts dividends paid on the Series B Stock and, for 2011, amounts paid in excess of liquidation value in connection with the repurchase of certain shares of Series B Stock.

The change in presentation had no effect on any other amounts or financial statement line items. All prior periods have been restated to reflect such corrections. The following tables summarize the corrections to basic and diluted loss per share from continuing operations for each of the affected fiscal years.

	For the Fiscal Year Ended 2011		
	As Reported	Adjustment	As Restated
Per common share:			
Basic loss from continuing operations	$ (0.74)	$ (0.55)	$ (1.29)
Diluted loss from continuing operations	$ (0.74)	$ (0.55)	$ (1.29)

Table of Contents

MATTERSIGHT CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	For the Fiscal Year Ended 2010		
	As Reported	**Adjustment**	**As Restated**
Per common share:			
Basic loss from continuing operations	$ (1.19)	$ (0.09)	$ (1.28)
Diluted loss from continuing operations	$ (1.19)	$ (0.09)	$ (1.28)

	For the Fiscal Year Ended 2009		
	As Reported	**Adjustment**	**As Restated**
Per common share:			
Basic loss from continuing operations	$ (1.16)	$ (0.10)	$ (1.26)
Diluted loss from continuing operations	$ (1.16)	$ (0.10)	$ (1.26)

The following table (unaudited) summarizes the corrections to basic and diluted loss per share from continuing operations for the quarters in Fiscal Year Ended 2011 and Fiscal Year Ended 2010:

	For the Fiscal Year Ended 2011				
	1st	**2nd**	**3rd**	**4th (1)**	**Year**
Basic loss from continuing operations per share as reported	$ (0.34)	$ (0.05)	$ (0.18)	$ (0.17)	$ (0.74)
Basic loss from continuing operations per share as restated	$ (0.36)	$ (0.08)	$ (0.20)	$ (0.64)	$ (1.29)
Adjustment	$ (0.02)	$ (0.03)	$ (0.02)	$ (0.47)	$ (0.55)
Diluted loss from continuing operations per share as reported	$ (0.34)	$ (0.05)	$ (0.18)	$ (0.17)	$ (0.74)
Diluted loss from continuing operations per share as restated	$ (0.36)	$ (0.08)	$ (0.20)	$ (0.64)	$ (1.29)
Adjustment	$ (0.02)	$ (0.03)	$ (0.02)	$ (0.47)	$ (0.55)

	For the Fiscal Year Ended 2010				
	1st	**2nd**	**3rd**	**4th**	**Year**
Basic loss from continuing operations per share as reported	$ (0.36)	$ (0.33)	$ (0.27)	$ (0.23)	$ (1.19)
Basic loss from continuing operations per share as restated	$ (0.38)	$ (0.35)	$ (0.30)	$ (0.25)	$ (1.28)
Adjustment	$ (0.02)	$ (0.02)	$ (0.03)	$ (0.02)	$ (0.09)
Diluted loss from continuing operations per share as reported	$ (0.36)	$ (0.33)	$ (0.27)	$ (0.23)	$ (1.19)
Diluted loss from continuing operations per share as restated	$ (0.38)	$ (0.35)	$ (0.30)	$ (0.25)	$ (1.28)
Adjustment	$ (0.02)	$ (0.02)	$ (0.03)	$ (0.02)	$ (0.09)

(1) The adjustment made in the fourth quarter of Fiscal Year 2011 includes amounts paid in excess of liquidation value in connection with the redemption of certain shares of Series B Stock in addition to periodic dividends on the Series B Stock.

Table of Contents

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:					
Fiscal year ended December 31, 2011	$				$
Fiscal year ended January 1, 2011	$				$
Fiscal year ended December 26, 2009	$				$
Valuation allowance for deferred tax assets:					
Fiscal year ended December 31, 2011	$ 62.7	(6.9)			$ 55.8
Fiscal year ended January 1, 2011	$ 58.4	4.3			$ 62.7
Fiscal year ended December 26, 2009	$ 56.8	1.6			$ 58.4

Table of Contents

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

In our Original Form 10-K, management concluded that our disclosure controls and procedures were effective as of December 31, 2011. In connection with the restatements discussed above in the explanatory note to this Amendment No. 1 and in Note Twenty-Two of our financial statements, under the direction of our Chief Executive Officer and Chief Financial Officer, we reevaluated our disclosure controls and procedures. We identified a material weakness in our internal control over financial reporting related to the process and procedures used in applying appropriate accounting to basic and diluted loss per share from continuing operations. Specifically, the Company did not deduct for dividends and in 2011, other payments made in respect of the Series B Stock, in accordance with Accounting Standards Codification 260, *Earnings Per Share.* Solely as a result of this material weakness, we concluded that our disclosure controls and procedures were not effective as of December 31, 2011.

(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 to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. The Company conducted its evaluation of the effectiveness of internal control over financial reporting using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control Integrated Framework.*

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.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis.

In the Company s Original Form 10-K for the year ended December 31, 2011, filed on March 15, 2012, management concluded that our internal control over financial reporting was effective as of December 31, 2011. Subsequently, our management identified a deficiency in respect of our internal control over financial reporting, specifically in our controls over the computation of basic and diluted loss per share from continuing operations that constitutes a material weakness as described in SEC s guidance regarding Management s Report on Internal Control Over Financial Reporting as of December 31, 2011. As a result of this deficiency, the financial statements included in the Original Form 10-K for the year ended December 31, 2011, included an error related to the presentation and disclosure of our basic and diluted loss per share from continuing operations. As a result of this material weakness, management concluded that we did not maintain effective internal control over financial reporting as of December 31, 2011, based on the criteria established in *Internal Control Integrated Framework* , issued by the COSO.

Subsequent to the discovery of our material weakness, we have changed our internal control process and procedures used in applying the appropriate accounting to the basic and diluted loss per share from continuing operations. Specifically, we have corrected the method by which we compute basic and diluted loss per share from continuing operations to make requisite deductions for dividends and other payments made in respect of the Series B Stock. We believe these actions have strengthened our internal control over financial reporting and will address the material weakness identified as of December 31, 2011.

(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 Form 10-K/A 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 6, which is incorporated herein by reference.

Table of Contents

(d) Changes in Internal Control over Financial Reporting

Except as has been described above, there has been no change in Mattersight s internal control over financial reporting that occurred during the fourth quarter of fiscal year 2011 that has materially affected, or is reasonably likely to materially affect, Mattersight s internal control over financial reporting.

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 Form 10-K/A 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 Form 10-K/A 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.

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on May 14, 2012.

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 report has been signed below by the following persons on behalf of the registrant in the capacities indicated on May 14, 2012.

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
* David B. Mullen	Director
* Michael J. Murray	Director
* John C. Staley	Director
/s/ WILLIAM B. NOON William B. Noon	Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)

*By: /s/ WILLIAM B. NOON
William B. Noon, Attorney-in-Fact

Table of Contents

EXHIBIT INDEX

We are including as exhibits to this Form 10-K/A 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.

Exhibit No.	Description of Exhibit
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.
24.7*	Power of Attorney from David B. Mullen, Director.
31.1+	Certification of Kelly D. Conway under Section 302 of the Sarbanes-Oxley Act of 2002.
31.2+	Certification of William B. Noon under Section 302 of the Sarbanes-Oxley Act of 2002.
32.1+	Certification of Kelly D. Conway and William B. Noon 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/A for the year ended December 31, 2011, is formatted in eXtensible Business Reporting Language (XBRL): (i) Consolidated Balance Sheets as of December 31, 2011 and January 1, 2011; (ii) Consolidated Statements of Operations for the fiscal years ended December 31, 2011, January 1, 2011, and December 26, 2009; (iii) Consolidated Statements of Cash Flows for the fiscal years ended December 31, 2011, January 1, 2011, and December 26, 2009; (iv) Consolidated Statements of Changes in Stockholders Equity (Deficit) and Comprehensive Loss for the fiscal years ended December 31, 2011, January 1, 2011, and December 26, 2009; (v) notes to the Consolidated Financial Statements; and (vi) Financial Statement Schedule II.

+ Filed herewith.
* Previously filed.
** The following XBRL information, is being furnished and not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is not incorporated by reference into any registration statement under the Securities Act of 1933, as amended.