EGAIN Corp
Form 10-Q
May 09, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2014

OR

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

For the transition period from to

Commission File No. 001-35314

eGAIN CORPORATION

(Exact name of registrant as specified in its charter)

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

(408) 636-4500

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes 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 (§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 whether the registrant is a large accelerated filer, an accelerated filer, or non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer"; "accelerated filer" and "smaller reporting company", in Rule 12b-2 of the Exchange Act (check one):

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

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

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

Class	Outstanding at May 5, 2014
Common Stock $0.001 par value	25,454,405

eGAIN CORPORATION

Quarterly Report on Form 10-Q

For the Quarterly Period Ended March 31, 2014

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

eGAIN CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except par value data)

	March 31, 2014	June 30, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$7,769	$16,206
Restricted cash	30	29
Accounts receivable, less allowance for doubtful accounts of $658 and $392 at March 31, 2014 and June 30, 2013, respectively	9,495	12,307
Deferred commissions	1,111	1,745
Prepaid and other current assets	1,583	2,377
Total current assets	19,988	32,664
Property and equipment, net	4,308	3,544
Deferred commission, net of current portion	336	776
Goodwill	4,880	4,880
Restricted cash, net of current portion	1,000	1,000
Other assets	738	672
Total assets	$31,250	$43,536
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$2,194	$2,583
Accrued compensation	4,423	4,339
Accrued liabilities	1,300	2,478
Deferred revenue	14,973	15,679
Capital lease obligation	176	—
Bank borrowings	1,417	2,667
Related party notes payable	—	2,897
Total current liabilities	24,483	30,643
Deferred revenue, net of current portion	871	4,057
Capital lease obligation, net of current portion	187	—
Bank borrowings, net of current portion	1,250	2,000
Other long term liabilities	761	848
Total liabilities	27,552	37,548
Commitments and contingencies (Note 6)		

Stockholders' equity:		
Common stock, $0.001 par value - authorized: 50,000 shares; outstanding: 25,453 shares as of March 31, 2014 and 25,106 as of June 30, 2013	25	25
Additional paid-in capital	330,321	328,552
Notes receivable from stockholders	(89)	(87)
Accumulated other comprehensive loss	(997)	(1,168)
Accumulated deficit	(325,562)	(321,334)
Total stockholders' equity	3,698	5,988
Total liabilities and stockholders' equity	$31,250	$43,536

See accompanying notes to condensed consolidated financial statements

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eGAIN CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

(in thousands, except per share data)

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2014	2013	2014	2013
Revenue:				
Subscription and support	$10,608	$8,346	$30,320	$23,326
License	2,519	4,098	9,422	8,237
Professional services	4,899	3,016	11,631	9,357
Total revenue	18,026	15,460	51,373	40,920
Cost of subscription and support	2,238	1,355	6,160	3,959
Cost of license	28	34	80	125
Cost of professional services	3,716	3,180	11,111	9,095
Total cost of revenue	5,982	4,569	17,351	13,179
Gross profit	12,044	10,891	34,022	27,741
Operating expenses:				
Research and development	2,668	2,101	7,164	6,193
Sales and marketing	8,628	6,027	24,640	17,522
General and administrative	1,436	1,852	5,572	4,929
Total operating expenses	12,732	9,980	37,376	28,644
Income (loss) from operations	(688)	911	(3,354)	(903)
Interest expense, net	(17)	(99)	(146)	(376)
Other income (expense), net	(77)	256	(355)	306
Income (loss) before income tax provision	(782)	1,068	(3,855)	(973)
Income tax provision	(225)	(38)	(373)	(240)
Net income (loss)	$(1,007)	$1,030	$(4,228)	$(1,213)
Per share information:				
Basic net income (loss) per common share	$(0.04)	$0.04	$(0.17)	$(0.05)
Diluted net income (loss) per common share	$(0.04)	$0.04	$(0.17)	$(0.05)
Weighted average shares used in computing basic net income (loss) per common share	25,418	24,889	25,316	24,690
Weighted average shares used in computing diluted net income (loss) per common share	25,418	26,373	25,316	24,690

See accompanying notes to condensed consolidated financial statements

eGAIN CORPORATION

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

(in thousands)

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2014	2013	2014	2013
Net income (loss)	$(1,007)	$1,030	$(4,228)	$(1,213)
Other comprehensive income / (loss), net of taxes:				
Foreign currency translation adjustments	23	(242)	171	(279)
Comprehensive income / (loss)	$(984)	$788	$(4,057)	$(1,492)

See accompanying notes to condensed consolidated financial statements

eGAIN CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(in thousands)

	Nine Months Ended March 31, 2014	2013
Cash flows from operating activities:		
Net loss	$(4,228)	$(1,213)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,537	938
Amortization of deferred commissions	1,468	1,118
Stock-based compensation	1,210	810
Provisions for doubtful accounts	493	305
Accrued interest on related party notes payable	19	278
Changes in operating assets and liabilities:		
Accounts receivable	2,858	(4,142)
Deferred commissions	(360)	(1,948)
Prepaid expenses and other assets	827	(1,386)
Accounts payable	(598)	(117)
Accrued compensation	(50)	305
Accrued liabilities	(1,246)	1,425
Deferred revenue	(4,333)	12,613
Other long term liabilities	(112)	39
Net cash provided by (used in) operating activities	(2,515)	9,025
Cash flows from investing activities:		
Decrease (increase) in restricted cash	(1)	6
Purchases of property and equipment	(1,585)	(1,190)
Net cash used in investing activities	(1,586)	(1,184)
Cash flows from financing activities:		
Payment on related party notes payable	(2,916)	(3,000)
Payments on bank borrowings	(2,000)	(1,250)
Payments on capital lease obligations	(119)	—
Proceeds from bank borrowings	—	3,000
Proceeds from exercise of stock options	557	532
Net cash used in financing activities	(4,478)	(718)
Effect of change in exchange rates on cash and cash equivalents	142	(276)
Net increase (decrease) in cash and cash equivalents	(8,437)	6,847
Cash and cash equivalents at beginning of period	16,206	9,911
Cash and cash equivalents at end of period	$7,769	$16,758

Supplemental cash flow disclosures:		
Cash paid for interest	$176	$1,864
Cash paid for taxes	$231	$228
Non-cash items:		
Purchases of equipment through trade accounts payable	$154	$85
Property and equipment acquired under a capital lease	$482	$—

See accompanying notes to condensed consolidated financial statements

eGAIN CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 1. Summary of Business and Significant Accounting Policies

Organization and Nature of Business

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

Principles of Consolidation

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

These financial statements and notes should be read in conjunction with our audited consolidated financial statements and notes thereto for the fiscal year ended June 30, 2013, included in our Annual Report on Form 10-K. The condensed consolidated balance sheet as of June 30, 2013 has been derived from audited financial statements as of that date but does not include all the information and footnotes required by GAAP for complete financial statements. The results of our operations for the interim periods presented are not necessarily indicative of results that may be expected for any other interim period or for the full fiscal year ending June 30, 2014.

Segment Information

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

Information relating to our geographic areas for the three and nine months ended March 31, 2014 and 2013 is as follows (unaudited, in thousands):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2014	2013	2014	2013
Total Revenue:				
North America	$9,562	$9,372	$27,435	$24,025
EMEA	8,127	6,014	22,783	16,685
Asia Pacific	337	74	1,155	210
	$18,026	$15,460	$51,373	$40,920
Operating Income (Loss):				
North America	$(569)	$1,264	$(1,607)	$1,379
EMEA	1,118	890	1,474	1,497
Asia Pacific*	(1,237)	(1,243)	(3,221)	(3,779)
	$(688)	$911	$(3,354)	$(903)

*Includes costs associated with corporate support.

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

	March 31, 2014	June 30, 2013
Identifiable Tangible Assets:		
North America	$13,007	$25,939
EMEA	10,441	10,964
Asia Pacific	2,867	1,698
	$26,315	$38,601

The following table provides total revenue by category for the three and nine months ended March 31, 2014 and 2013, respectively, (unaudited, in thousands):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2014	2013	2014	2013
Revenue:				
Cloud services	$7,039	$5,200	$19,806	$13,429
Maintenance and support services	3,569	3,146	10,514	9,897
License	2,519	4,098	9,422	8,237
Professional services	4,899	3,016	11,631	9,357
	$18,026	$15,460	$51,373	$40,920

For the three months ended March 31, 2014, there was one customer that accounted for 10% and another for 16% of total revenue. For the three months ended March 31, 2013, there was one customer that accounted for 10% and another for 20% of total revenue. For the nine months ended March 31, 2014 and 2013, there was one customer that accounted for 17% and 18% of total revenue, respectively.

Revenue Recognition

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

We derive revenue from three sources:

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

(iii) Professional services primarily consist of consulting, implementation services and training.

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

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

Delivery or performance has occurred: Software is delivered to customers electronically or on a CD-ROM, and license files are delivered electronically. Delivery is considered to have occurred when we provide the customer access to the software along with login credentials.

Fees are fixed or determinable: We assess whether the fee is fixed or determinable based on the payment terms associated with the transaction. Arrangements where a significant portion of the fee is due beyond 90 days from delivery are generally not considered to be fixed or determinable.

Collectibility is probable: We assess collectibility based on a number of factors, including the customer's past payment history and its current creditworthiness. Payment terms generally range from 30 to 90 days from invoice date. If we determine that collection of a fee is not reasonably assured, we defer the revenue and recognize it at the time collection becomes reasonably assured, which is generally upon receipt of cash payment.
We apply the provisions of ASC 985-605, Software Revenue Recognition, to all transactions involving the licensing of software products. In the event of a multiple element arrangement for a license transaction, we evaluate the transaction as if each element represents a separate unit of accounting taking into account all factors following the accounting standards. We apply ASC 605, Revenue Recognition, for cloud transactions to determine the accounting treatment for multiple elements. We also apply ASC 605-35 for fixed fee arrangements in which we use the percentage of completion method to recognize revenue when reliable estimates are available for the costs and efforts necessary to complete the implementation services. When such estimates are not available, the completed contract method is utilized. Under the completed contract method, revenue is recognized only when a contract is completed or substantially complete.

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

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

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

Subscription and Support Revenue

Cloud Revenue

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

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

Term License Revenue

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

Maintenance and Support Revenue

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

License Revenue

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

We periodically sell to resellers. License sales to resellers as a percentage of total revenue were approximately 6% and 15% for the three months ended March 31, 2014 and 2013, respectively. License sales to resellers as a percentage of total revenue were approximately 8% and 7% for the nine months ended March 31, 2014 and 2013, respectively. Revenue from sales to resellers is generally recognized upon delivery to the reseller but depends on the facts and circumstances of the transaction, such as our understanding of the reseller’s plans to sell the software, if there are any return provisions, price protection or other allowances, the reseller’s financial status and our experience with the particular reseller. Historically sales to resellers have not included any return provisions, price protections or other allowances.

Professional Services Revenue

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

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

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

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

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

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

Deferred Revenue

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

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

Deferred Commissions

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

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

Accounts Receivable and Allowance for Doubtful Accounts

We extend unsecured credit to our customers on a regular basis. Our accounts receivable are derived from revenue earned from customers and are not interest bearing. We also maintain an allowance for doubtful accounts to reserve for potential uncollectible trade receivables. We review our trade receivables by aging category to identify specific customers with known disputes or collectibility issues. We exercise judgment when determining the adequacy of these reserves as we evaluate historical bad debt trends, general economic conditions in the U.S. and internationally, and changes in customer financial conditions. If we made different judgments or utilized different estimates, material differences may result in additional reserves for trade receivables, which would be reflected by charges in general and administrative expenses for any period presented. We write off a receivable after all collection efforts have been exhausted and the amount is deemed uncollectible.

Receivable from Insurance Recovery

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

Deferred Costs

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

Leases

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

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

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

Stock-Based Compensation

We account for stock-based compensation in accordance with ASC 718, Compensation—Stock Compensation. Under the fair value recognition provisions of ASC 718, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the vesting period. Determining the fair value of the stock-based awards at the grant date requires significant judgment and the use of estimates, particularly surrounding Black-Scholes valuation model assumptions such as stock price volatility and expected option term.

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2014	2013	2014	2013
Stock-Based Compensation:				
Cost of revenue	$92	$28	$244	$87
Research and development	102	57	201	212
Sales and marketing	179	70	472	256
General and administrative	97	70	293	255
Total stock-based compensation expense:	$470	$225	$1,210	$810

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

During the three months ended March 31, 2014 and 2013 there were 274,650 and 26,550 shares of common stock granted with a weighted-average fair value of $5.08 and $4.82 per share, respectively. During the nine months ended March 31, 2014 and 2013 there were 536,500 and 183,800 shares of common stock granted, respectively, with a weighted-average fair value of $6.09 and $3.25 per share, respectively, using the following assumptions:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2014	2013	2014	2013
Dividend yield	—	—	—	—
Expected volatility	80 %	85 %	80 %	88 %
Average risk-free interest rate	1.60%	0.83%	1.52%	0.71%
Expected life (in years)	4.50	4.50	4.50	4.50

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

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

Total compensation cost, net of forfeitures, of all options granted but not yet vested as of March 31, 2014 was $2,855,916, which is expected to be recognized over the weighted average period of 1.54 years. There were 58,899 and 347,381 options exercised for the three and nine months ended March 31, 2014 and 222,717 and 506,786 options exercised for three and nine months ended March 31, 2013.

New Accounting Pronouncements

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

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

Note 2. Net Income (Loss) per Common Share

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

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2014	2013	2014	2013
Net income (loss) applicable to common stockholders	$(1,007)	$1,030	$(4,228)	$(1,213)
Basic net income (loss) per common stock	$(0.04)	$0.04	$(0.17)	$(0.05)
Weighted-average common shares used in computing basic net income (loss) per common share	25,418	24,889	25,316	24,690
Effect of dilutive options	—	1,484	—	—
Weighted-average common shares used in computing diluted net income (loss) per common share	25,418	26,373	25,316	24,690
Diluted net income (loss) per common stock	$(0.04)	$0.04	$(0.17)	$(0.05)

Weighted average shares of stock options to purchase 2,152,759 and 2,191,672 shares of common stock for the three and nine months ended March 31, 2014 and 132,927 and 2,558,048 shares of common stock for the three and nine months ended March 31, 2013 were not included in the computation of diluted net income (loss) per common share due to their anti-dilutive effect. Such securities could have a dilutive effect in future periods.

Note 3. Related Party Notes Payable

	Maturity	Interest Rate	March 31, 2014	June 30, 2013
Related party notes payable	7/31/2013	8 %	$ —	$ 2,897

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

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

On July 31, 2013, we repaid the outstanding amount of $2.9 million owed to Mr. Roy and terminated the loan agreement. Interest expense on the related party notes was $0 and $56,000, respectively, for the three months ended March 31, 2014 and 2013. Interest expense on the related party notes was $19,000 and $278,000, respectively, for the nine months ended March 31, 2014 and 2013.

Note 4. Bank Borrowings

On June 27, 2011, we entered into a Loan and Security Agreement, or the Comerica Credit Facility, with Comerica Bank, or Comerica, as may be amended from time to time. Our obligations under the Comerica Credit Facility are collateralized by a lien on our assets. In addition, Mr. Roy subordinated his security interests to those of Comerica pursuant to a Subordination Agreement dated as of June 27, 2011. The Comerica Credit Facility also provided $5.0 million to pay off obligations associated with our related parties, or the Comerica Term Loan, bears interest at a rate of prime plus 1.0% per annum, and is payable in 36 equal monthly payments of principal and interest with a maturity date of June 15, 2014. There are a number of affirmative and negative covenants under the Comerica Credit Facility, with the primary covenants being that we are required to maintain a minimum cash balance of $1.0 million and we must maintain a liquidity to debt ratio of at least 1.50 to 1.00. If we fail to comply with our covenants, Comerica can declare any outstanding amounts immediately due and payable and stop extending credit to us. As of March 31, 2014 we were in compliance with the covenants. Additionally, we account for the $1.0 million minimum cash balance as non-current restricted cash as the funds are not available for immediate withdraw or use and the term of the borrowing arrangement is more than 12 months. The Comerica Credit Facility also required Mr. Roy’s remaining related party debt to be repaid or converted to equity by the end of December 2011. Pursuant to an Amendment to the Loan and Security Agreement entered into on December 28, 2011, the time period in which Mr. Roy’s remaining related party debt to be repaid or converted to equity was extended to June 30, 2012. On June 28, 2012, we entered into another amendment that further extended the maturity date to July 31, 2013. In addition, Mr. Roy entered into an Affirmation of Subordination Agreement with Comerica, under which Mr. Roy acknowledged our execution of the Second

Amendment and affirmed his obligations under the Subordination Agreement with Comerica dated June 27, 2011.

On December 28, 2012, we entered into a Third Amendment to Loan and Security Agreement with Comerica, which amended the Second Loan and Security Agreement, entered into by the Company and the Bank on June 28, 2012. Subject to and upon the terms and conditions of the Loan Amendment, the Bank agreed to make a term loan to the Company in one disbursement in the amount of $3.0 million, which the Company was obligated to use to pay down indebtedness owed to Mr. Roy. As of March 31, 2014 and June 30, 2013, the amount outstanding under the Comerica Term Loans was $2.7 million and $4.7 million, respectively.

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

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

Note 5. Income Taxes

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

The Company accounts for uncertain tax positions according to the provisions of ASC 740. ASC 740 contains a two-step approach for recognizing and measuring uncertain tax positions. Tax positions are evaluated for recognition by determining if the weight of available evidence indicates that it is probable that the position will be sustained on audit, including resolution of related appeals or litigation. Tax benefits are then measured as the largest amount which is more than 50% likely of being realized upon ultimate settlement. The Company considers many factors when evaluating and estimating tax positions and tax benefits, which may require periodic adjustments and which may not accurately anticipate actual outcomes. No material changes have occurred in the Company’s tax positions taken as of June 30, 2013 and in the three and nine months ended March 31, 2014.

Note 6. Commitments and Contingencies

Warranty

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

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

Historically, costs related to these warranties have not been significant. Accordingly, we have no liabilities recorded for these costs as of March 31, 2014 and June 30, 2013. However, we cannot guarantee that a warranty reserve will not become necessary in the future.

Indemnification

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

Transfer pricing

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

Litigation

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

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

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

Note 7. Fair Value Measurement

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

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

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

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

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

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

	As of March 31, 2014		As of June 30, 2013	
	Level 1	Total Balance	Level 1	Total Balance
Assets				
Cash, cash equivalent and restricted cash:				
Money market funds	$4,321	$ 4,321	$ 10,016	$ 10,016
Total assets	$4,321	$ 4,321	$ 10,016	$ 10,016

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

As of March 31, 2014 and June 30, 2013, we did not have any Level 2 or 3 assets or liabilities.

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

Note 8. Share Repurchase Program

On September 14, 2009, we announced that our board of directors approved a repurchase program under which we may purchase up to 1,000,000 shares of our common stock. The duration of the repurchase program is open-ended. Under the program, we purchase shares of common stock from time to time through the open market and privately negotiated transactions at prices deemed appropriate by management. The repurchase is funded by cash on hand. For the three and nine months ended March 31, 2014 and 2013, there were no shares repurchased.

Note 9. Subsequent Events

On April 30, 2014, we entered into the Fourth Amendment to Loan and Security Agreement (the “Amendment”) with Comerica, which amends the Comerica Credit Facility entered into by the Company and Comerica on June 27, 2011, as amended. Pursuant to the Amendment and subject to the terms and conditions contained therein, Comerica approved a loan of $3.0 million dollars for working capital as well as a revolving line of credit to the Company in the amount of up to $7.0 million dollars.

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

The following discussion in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” (“MD&A”) contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). These statements may be identified by the use of the words such as “expects”, “aims”, “anticipates,” “believes,” “contin “could,” “would,” “estimates,” “expects,” “intends,” “may,” “might,” “plans,” “potential”, ”projects”, “seeks” “assumes”, “sho similar expressions or the negative of those terms. The forward-looking statements include, but are not limited to, statements regarding: the effect of changes in macroeconomic factors beyond our control; our hybrid revenue model and its potential impact on our total revenue; our ability to predict subscription renewals or upgrade rates; our lengthy sales cycles and the difficulty in predicting timing of sales or delays; competition in the markets in which we do business and our failure to compete successfully therein; our expectations regarding the composition of our customers and the result of a loss of a significant customer; the adequacy of our capital resources and need for additional financing and the effect of failing to obtain adequate funding; the development and expansion of our strategic and third party distribution partnership and relationships with systems integrators; our ability to effectively implement and improve our current products; our ability to innovate and respond to rapid technological change and competitive challenges; legal liability or the effect of negative publicity for the services provided to consumers via our technology platforms; legal and regulatory uncertainties and other risks related to protection of our intellectual property assets; our ability to anticipate our competitors; the operational integrity and maintenance of our systems; the effect of unauthorized access to a customer’s data or our data or our IT systems; the uncertainty of demand for our products; the anticipated customer benefits from our products; the actual mix in new business between cloud and license transactions when compared with management’s projections; our ability to develop and expand strategic and third party distribution channels; the ability to increase revenue as a result of the increased investment in sales and marketing; our ability to hire additional personnel and retain key personnel; the effect of any future changes to our sales organization on our revenue growth rate; our ability to expand and improve our sales performance and marketing activities; our ability to manage our expenditures and estimate future expenses, revenue, and operational requirements; the expenses associated with new data centers, additional data center capacity, real estate and office facilities space; our ability to manage our business plans, strategies and outlooks and any business-related forecasts or projections; the effect of the voluntary change in our accounting policy on our ability to compare our financial results with our industry peers; the effect of changes to management judgments and estimates; risks associated with the uncertainty of pending litigation; the result of our failure to comply with the covenants under the Comerica Loan; the impact of any modification to our pricing practices in the future; risks from our substantial international operations; our inability to successfully detect weaknesses or errors in our internal controls; our ability to manage future growth; the trading price of our common stock; geographical and currency fluctuations; and our expectations in fiscal 2014 with respect to revenue, cost of revenue, expenses and other financial metrics. Forward looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those expected. These risks and uncertainties include, but are not limited to, those risks discussed in “Risk Factors” Item 1A in this report and in our Annual Report on Form 10-K for the fiscal year ended June 30, 2013 which is incorporated herein by reference. Our actual results could differ materially from those discussed in statements relating to our future plans, product releases, objectives, expectations and intentions, and other assumptions underlying or relating to any of these statements. These forward-looking statements are subject to risks, uncertainties and assumptions that are difficult to predict. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. Readers are directed to risks and uncertainties identified below, under “Risk Factors” and elsewhere in this report, for factors that may cause actual results to be different than those expressed in these forward-looking statements. Except as required by law, we undertake no obligation to revise or update publicly any forward-looking statements for any reason.

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

Overview

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

Unbilled Deferred Revenue

Unbilled deferred revenue represents business that is contracted but not yet invoiced or collected and off–balance-sheet and, accordingly, is not recorded in deferred revenue. As such, the deferred revenue balance on our condensed consolidated balance sheets does not represent the total contract value of annual or multi-year, non-cancelable subscription agreements. As of March 31, 2014, unbilled deferred revenue decreased to $15.7 million, from approximately $24.8 million as of June 30, 2013.

Critical Accounting Policies and Estimates

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

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

We have reassessed the critical accounting policies as disclosed in our Annual Report on Form 10-K filed with the SEC on September 23, 2013 and determined that there were no significant changes to our critical accounting policies in the nine months ended March 31, 2014.

Revenue Recognition

We derive revenue from three sources:

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

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

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

Subscription and Support Revenue

Cloud Revenue

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

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

Term License Revenue

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

Maintenance and Support Revenue

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

License Revenue

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

We periodically sell to resellers. License sales to resellers as a percentage of total revenue were approximately 6% and 15% for the three months ended March 31, 2014 and 2013, respectively. License sales to resellers as a percentage of total revenue were approximately 8% and 7% for the nine months ended March 31, 2014 and 2013, respectively. Revenue from sales to resellers is generally recognized upon delivery to the reseller but depends on the facts and circumstances of the transaction, such as our understanding of the reseller’s plans to sell the software, if there are any return provisions, price protection or other allowances, the reseller’s financial status and our experience with the particular reseller. Historically sales to resellers have not included any return provisions, price protections or other allowances.

Professional Services Revenue

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

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

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

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

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

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

Deferred Revenue

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

Deferred revenue that will be recognized during the succeeding twelve month period is recorded as current deferred revenue and the remaining portion is recorded as noncurrent. As of March 31, 2014, deferred revenue decreased to $15.8 million, compared to $19.7 million at June 30, 2013.

Deferred Commissions

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

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

Results of Operations

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2014	2013	2014	2013
Revenue:				
Subscription and support	59 %	54 %	59 %	57 %
License	14 %	26 %	18 %	20 %
Professional services	27 %	20 %	23 %	23 %
Total revenue	100%	100 %	100%	100 %
Cost of subscription and support	12 %	9 %	12 %	10 %
Cost of license	0 %	0 %	0 %	0 %
Cost of professional services	21 %	21 %	22 %	22 %
Total cost of revenue	33 %	30 %	34 %	32 %
Gross profit	67 %	70 %	66 %	68 %
Operating expenses:				
Research and development	15 %	13 %	14 %	15 %
Sales and marketing	48 %	39 %	48 %	43 %
General and administrative	8 %	12 %	11 %	12 %
Total operating expenses	71 %	64 %	73 %	70 %
Income (loss) from operations	(4)%	6 %	(7)%	(2)%

Revenue

	Three Months Ended March 31,				Nine Months Ended March 31,			
(in thousands)	2014	2013	Change	%	2014	2013	Change	%
Subscription and support	10,608	8,346	2,262	27 %	30,320	23,326	6,994	30%
License	2,519	4,098	(1,579)	(39)%	9,422	8,237	1,185	14%
Professional services	4,899	3,016	1,883	62 %	11,631	9,357	2,274	24%
Total revenue	$18,026	$15,460	$2,566	17 %	$51,373	$40,920	$10,453	26%

Total revenue increased 17% to $18.0 million in the quarter ended March 31, 2014 from $15.5 million in the comparable year-ago quarter. Total revenue for the nine months ended March 31, 2014 increased 26% to $51.4 million, compared to $40.9 million in the same period last year. Subscription and support revenue, which is comprised of cloud, term license and software maintenance and support revenue increased 27% to $10.6 million in the quarter ended March 31, 2014 from $8.3 million in the comparable year-ago quarter. Subscription and support revenue for the nine months ended March 31, 2014 increased 30% to $30.3 million, compared to $23.3 million in the same period last year. The increase in subscription and support revenue was primarily due to the expansion within our current customer base and new cloud contracts. License revenue decreased 39% to $2.5 million in the quarter ended March 31, 2014 from $4.1 million in the comparable year-ago quarter. License revenue for the nine months ended March 31, 2014 increased 14% to $9.4 million, compared to $8.2 million in the same period last year. Professional services revenue increased 62% to $4.9 million in the quarter ended March 31, 2014 from $3.0 million in the comparable year-ago quarter. Professional services revenue for the nine months ended March 31, 2014 increased 24% to $11.6 million, compared to $9.4 million in the same period last year. The increase in professional services revenue was primarily due to the professional services for cloud arrangements which we determined to have value to the customer on a standalone basis as of July 1, 2013 and therefore are accounted for separately. When accounted for separately, these professional services revenues would generally be recognized as the services are rendered. Prior to this, professional services revenue for cloud arrangements were recognized ratably over the longer of the remaining contractual period or the average estimated life of the customer cloud relationship, once the cloud has gone live or system ready.

Revenue in Europe and Asia Pacific increased 39% to $8.5 million in the quarter ended March 31, 2014 from $6.1 million in the comparable year-ago quarter. Revenue in Europe and Asia Pacific for the nine months ended March 31, 2014 increased 42% to $23.9 million from $16.9 million in the same period last year. The increase in revenue outside of the Americas demonstrates increased acceptance of our product world-wide. The impact of the foreign exchange fluctuation between the U.S. Dollar and the Euro and British Pound resulted in a net increase of $581,000 in total revenue for the three months ended March 31, 2014 as compared to the comparable year-ago quarter. The impact of the foreign exchange fluctuation between the U.S. Dollar and the Euro and British Pound resulted in a net increase of $594,000 in total revenue for the nine months ended March 31, 2014 as compared to the same period last year. To measure the impact of foreign exchange rate fluctuation, we recalculate current period results using the comparable prior period exchange rate.

Cost of Revenue

	Three Months Ended March 31,				Nine Months Ended March 31,			
(in thousands)	2014	2013	Change	%	2014	2013	Change	%
Subscription and support	$2,238	$1,355	$883	65 %	$6,160	$3,959	$2,201	56 %
License	28	34	(6)	(18)%	80	125	(45)	(36)%
Professional services	3,716	3,180	536	17 %	11,111	9,095	2,016	22 %
Total cost of revenue	$5,982	$4,569	$1,413	31 %	$17,351	$13,179	$4,172	32 %
Percentage of total revenue	33 %	30 %			34 %	32 %		
Gross margin	67 %	70 %			66 %	68 %		

Total cost of revenue increased 31% to $6.0 million in the quarter ended March 31, 2014 from $4.6 million in the comparable year-ago quarter. Total cost of revenue represented 33% and 30% of total revenue in the quarters ended March 31, 2014 and 2013, respectively. The change was primarily due to increases of (i) $1.0 million in personnel and personnel-related expenses; (ii) $376,000 in cloud related expenses such as hosted network and lease costs paid to remote co-location centers; (iii) $52,000 from the foreign exchange fluctuation between the U.S. Dollar, the Euro, British Pound and India Rupee partially offset by decreases of (i) $11,000 in outside consulting and (ii) $7,000 in license related expenses. Gross margin for the quarter ended March 31, 2014 was 67% compared to 70% in the comparable year-ago quarter.

Total cost of revenue for the nine months ended March 31, 2014 increased $4.2 million, or 32%, compared to the same period last year. The change was primarily due to increases of (i) $3.1 million in personnel and personnel-related expenses; (ii) $1.0 million in cloud related expenses such as hosted network and lease costs paid to remote co-location centers; (iii) $171,000 in outside consulting partially offset by decreases of (i) $88,000 from the foreign exchange fluctuation between the U.S. Dollar, the Euro, British Pound and India Rupee and (ii) $46,000 in license related expenses. Gross margin for the nine months ended March 31, 2014 and 2013 was 66% compared to 68% in the same period last year.

Operating Expenses

Research and Development

	Three Months Ended March 31,				Nine Months Ended March 31,			
(in thousands)	2014	2013	Change	%	2014	2013	Change	%
Research and development	$2,668	$2,101	$ 567	27%	$7,164	$6,193	$ 971	16%
Percentage of total revenue	15 %	13 %			14 %	15 %		

Research and development expense primarily consists of compensation and benefits for our engineering, product management and development, and quality assurance personnel, fees for outside consultants and, to a lesser extent, occupancy costs and related overhead. Total costs for research and development for the three months ended March 31, 2014 increased 27% to $2.7 million, compared to $2.1 million for the comparable year-ago quarter. The change was primarily due to an increase of (i) $616,000 in personnel and personnel-related expenses and (ii) $27,000 in outside consulting services partially offset by a decrease of $77,000 from the foreign exchange fluctuation between the U.S. Dollar, the Euro, British Pound and India Rupee. Total research and development revenue as a percentage of total revenue was 15% and 13% for the quarters ended March 31, 2014 and 2013, respectively.

Research and development costs for the nine months ended March 31, 2014 increased $971,000, or 16%, compared to the same period last year. The change was primarily due to an increase of $1.3 million in personnel and personnel-related expenses partially offset by decreases of (i) $223,000 from the foreign exchange fluctuation between the U.S. Dollar, the Euro, British Pound and India Rupee and (ii) $88,000 in outside consulting services. Total research and development revenue as a percentage of total revenue was 14% and 15% for the nine months ended March 31, 2014 and 2013, respectively.

Sales and Marketing

(in thousands)	Three Months Ended March 31, 2014	2013	Change	%	Nine Months Ended March 31, 2014	2013	Change	%
Sales and marketing	$8,628	$6,027	$2,601	43%	$24,640	$17,522	$7,118	41%
Percentage of total revenue	48 %	39 %			48 %	43 %		

Sales and marketing expense primarily consist of compensation and benefits for our sales, marketing and business development personnel, lead generation activities, advertising, trade show and other promotional costs and, to a lesser extent, occupancy costs and related overhead. Sales and marketing expense increased 43% to $8.6 million in the quarter ended March 31, 2014 from $6.0 million in the comparable year-ago quarter. The change was primarily due to increases of (i) $2.6 million in personnel and personnel-related expenses of which $197,000 relates to sales commissions; (ii) $188,000 from the foreign exchange fluctuation between the U.S. Dollar, the Euro, British Pound and India Rupee; (iii) $127,000 in marketing programs and public relations; and (iv) $26,000 from outside consulting services partially offset by a decrease of $348,000 in third party partner fees. Total sales and marketing expense as a percentage of total revenue was 48% and 39% for the quarters ended March 31, 2014 and 2013, respectively.

Sales and marketing expense for the nine months ended March 31, 2014 increased $7.1 million, or 41%, compared to the same period last year. The change was primarily due to increases of (i) $6.8 million in personnel and personnel-related expenses of which $524,000 relates to sales commissions; (ii) $593,000 in marketing programs and public relations; (iii) $196,000 from outside consulting services; and (iv) $194,000 from the foreign exchange fluctuation between the U.S. Dollar, the Euro, British Pound and India Rupee partially offset by a decrease of $672,000 in third party partner fees. Total sales and marketing expense as a percentage of total revenue was 48% and 43% for the nine months ended March 31, 2014 and 2013, respectively.

General and Administrative

Three Months Ended	Nine Months Ended