

Interactive looking past stock slump

*Software-maker positions itself to
outlast listless economic conditions*

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Interactive Intelligence Inc. is enduring a serious stock slump.

Its battered shares are trading around \$10, about \$20 off their 52-week peak. Yet CEO Don Brown remains so bullish on the software maker that he's authorized a

\$10 million stock buyback.

What does he see in Interactive Intelligence's prospects that common investors don't?

The answer boils down to the difference between a quarterly focus and a 10-year time line. In the short term, Interactive Intelligence will struggle to book sales in a sluggish economy. But in the long term, Brown is confident in his company's ability to adapt its cutting-edge customer-service software to the executive suite and other business functions.

"We believe it's a game-changer for us," Brown said.

When Brown founded Interactive Intelligence Inc. in 1994, his vision was to create a seamless suite of software products that unified and exponentially augmented business telephone systems. The company has done just that, and more. Today, Interactive Intelligence has 700 employees and 2,500 customers. Its system allows users to instantly

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organize, save and share all their communications via the Internet.

As a result, Interactive Intelligence has nearly doubled its revenue in the last three years.

Interactive Intelligence made \$17.5 million, or 91 cents a share, last year on revenue of \$110 million. All those figures were significantly higher than 2006 results. But profit and revenue are headed in opposite directions.

The company booked sales of \$30.6 million during 2008's second quarter—its highest tally ever. During the same quarter in 2005, Interactive Intelligence had \$15.6 million in revenue. But profit in the second quarter was a paltry \$845,000 compared with \$2.4 million a year ago.

Other than \$10.3 million in profit booked in the fourth quarter of last year, Interactive Intelligence's quarterly profits have generally fluctuated between high six figures and low seven figures.

This year, in recognition of the slowing economy, Interactive Intelligence lowered its annual revenue estimates—originally at 20 percent to 25 percent growth—down to 10 percent to 15 percent. Profit for the year is expected to follow the downward trend.

In a July 28 conference call with stock analysts, Brown explained the slowdown.

"We're not losing business to competitors, but instead seeing delays in purchases, even sometimes when we have verbal approvals, because of our more cautious buying environment," Brown said. "Our products are still being well-received."

The company's stock slump is a product of that slowing sales environment. And analysts remain primarily focused on Interactive Intelligence's near-term prospects.

Raymond James analyst



Shyam Patil, for example, currently rates Interactive Intelligence's stock "market perform," meaning it won't distinguish itself from other firms in its industry.

"While valuation is cheap ..." Patil wrote in a July 29 report, "and we believe the company's product offering, competitive positioning and long-term opportunity remain strong and unchanged," there's no reason to believe results will improve significantly in the near term.

Morgan Keegan & Co. analyst Tavis McCourt was even more blunt.

"Q2 was bad, no other way to put it," he wrote in a July 29 report. "Deferred revenues were down, orders declined year over year, gross margins declined modestly year over year, free cash flow was slightly negative. All of which leave little doubt that [the company] is being negatively affected by the economic slowdown."

At its current price, Brown believes Interactive Intelligence stock is a bargain. The company has no debt, and it's continuing to invest heavily in research and development, the aim of which is to do more than develop software that merely streamlines communications. The company's next generation of products will focus on analytics and improving business efficiency.

For example, in May, Interactive Intelligence released "Interaction Feedback," a customer satisfaction survey module that automatically measures whether callers were pleased after speaking to a company's call center.

In the pipeline is the next generation of the module, which will focus on automatic emotion and speech recognition. Brown said it will detect when callers are angry or upset, or if they use red-flag words such as a competitor's name. The system will then immediately direct irate callers to trained managers.

Eventually, Brown envisions spreading all this capacity beyond a company's customer contact center.

Interactive Intelligence's software

already allows call center managers to track who's in their seats and who's on a break, with inquiries automatically guided to available personnel. Managers can also quietly listen in on calls for spot checks.

In the future, Interactive Intelligence aims to apply the same concepts throughout businesses: delivering work instantly to people who are available now, then measuring their productivity and results. Future Interactive Intelligence users won't be call-center workers. They'll be insurance agents and money managers.

"What it does is, it extends the capabilities ... to people outside the contact center who may be very highly skilled, giving them the same structured work that is the key to the contact center. And giving supervisors the same sort of ability," Brown said. "It's sort of ironic. Today, a supervisor can keep track of everything a minimum-wage person does. Yet organizations have people making sometimes six figures, and they don't know exactly what they're doing."

Brown isn't the only one who believes Interactive Intelligence is built for a marathon, not a sprint. In July, *Business-Week* ranked the company 33rd among the "Top 50 Hot Growth Companies" in the United States. Just a few days later, *Fortune Small Business* placed it 10th among the 100 fastest-growing small public companies.

Drew Kraus, a research vice president for technology analyst Gartner Inc., said Brown's plan to take Interactive Intelligence beyond contact centers is a natural extension of its business model.

"What you're really looking at doing is automating and optimizing business processes. That's exactly what [Brown's] been doing for the last 25 years," Kraus said. "They come into it with momentum, because they know the contact center. It's a matter of extending that into the rest of the organization."

Interactive Intelligence board member Mark Hill is, like Brown, an IT entrepreneur. After he sold his banking software company Baker-Hill to Experian, Hill plowed the proceeds into a venture capital fund called Collina Ventures.

It's just not in Brown's nature to stand

still, Hill said.

“Don is quite a visionary, and very much understands the industry. He’s transforming the company, like all great companies have to do over time.”

Eventually, Interactive Intelligence’s short-term and long-term prospects will align again. And when that happens, Morgan Keegan’s McCourt expects the company’s stock to soar.

“The reason to own this stock is the growth that will likely be witnessed when the spending environment improves. We continue to believe [the firm] is at an early stage of its growth curve, has a superior product, and an experienced management team to execute on the opportunity,” he wrote. •

Interactive Intelligence made \$17.5 million last year on revenue of \$110 million. Those figures were higher than 2006 results.

“We believe it’s a game-changer for us.”

*Don Brown,
Interactive Intelligence CEO*

Although revenue climbs ...

Interactive Intelligence Inc. has consistently grown its revenue, but profit has proven variable. As a result, company stock hasn’t retained its peak of about \$30 a share.



... stock lags behind

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Source: Bloomberg News



Interactive Intelligence CEO Don Brown is bullish in the long-term

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