

ELOYALTY CORP  
Form DEF 14A  
April 26, 2011

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**SCHEDULE 14A**

**Proxy Statement Pursuant to Section 14(a) of the Securities**

**Exchange Act of 1934**

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

Preliminary Proxy Statement

Definitive Proxy Statement

Definitive Additional Materials

Soliciting Material Under Rule 14a-12

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**eLOYALTY CORPORATION**

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

No fee required.

Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:  
Not applicable

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(2) Aggregate number of securities to which transaction applies:

Not applicable

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (Set forth the amount on which the filing fee is calculated and state how it was determined):

The filing fee was determined based on the \$40,850,000 total consideration proposed to be paid to eLoyalty Corporation in the transaction.

(4) Proposed maximum aggregate value of transaction:

\$40,850,000

(5) Total fee paid:

\$4,742.69

The filing fee was calculated in accordance with Section 14(g) of the Securities Exchange Act of 1934, as amended, and was determined by multiplying \$.00011610 by the proposed maximum aggregate value of the transaction.

Fee paid previously with preliminary materials.

Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

150 Field Drive, Suite 250

Lake Forest, Illinois 60045

April 26, 2011

Dear eLoyalty Stockholder:

On behalf of the board of directors and management of eLoyalty Corporation, I cordially invite you to attend the 2011 Annual Meeting of eLoyalty's stockholders (the Annual Meeting). The Annual Meeting will be held at 9:00 a.m. Central Time on Thursday, May 19, 2011, at the LaQuinta Inn & Suites, 2000 S. Lakeside Drive, Bannockburn, IL 60015.

In addition to the election of three Class III directors, the ratification of the appointment of our independent public accountants for 2011, the approval, by a non-binding advisory vote, of our executive compensation program ( Say on Pay Proposal ), and a recommendation, by a non-binding advisory vote, for the frequency of advisory votes on our executive compensation program ( Frequency Vote on Say on Pay ), we are also seeking your approval for an important transaction. On March 17, 2011, eLoyalty entered into an acquisition agreement (the Acquisition Agreement) with TeleTech Holdings, Inc., a Delaware corporation, and Magellan Acquisition Sub, LLC, a Colorado limited liability company and wholly-owned subsidiary of TeleTech Holdings, Inc. (collectively, TeleTech), pursuant to which TeleTech will purchase substantially all of the assets, and assume certain of the liabilities, related to the Integrated Contact Solutions Business Unit and the eLoyalty registered trademark / trade name of eLoyalty Corporation. These assets and liabilities are referred to as the ICS Business. If the sale is completed, eLoyalty will receive cash consideration in the amount of \$40.85 million less certain adjustments as set forth in the Acquisition Agreement. The full text of the Acquisition Agreement is included as *Annex A* to the proxy statement that accompanies this letter.

At the Annual Meeting, eLoyalty will ask you to consider and vote upon a proposal to approve the sale of the ICS Business as contemplated by the Acquisition Agreement (the Proposal to Sell the ICS Business). You will also be asked to consider and vote upon a proposal to approve an amendment to our Certificate of Incorporation (the Charter) to change our name to Mattersight Corporation (the Name Change Charter Amendment). If there are insufficient votes in favor of the preceding proposals, eLoyalty will ask you to consider and vote upon a proposal to adjourn the Annual Meeting to solicit additional proxies (the Proposal to Adjourn the Annual Meeting).

Our board of directors, after careful consideration, has approved the Acquisition Agreement and determined that the Proposal to Sell the ICS Business and the Name Change Charter Amendment are advisable, fair to, and in the best interests of, eLoyalty and its stockholders. Our board of directors recommends that you vote **FOR** the Proposal to Sell the ICS Business, **FOR** the Name Change Charter Amendment, **FOR** the Proposal to Adjourn the Annual Meeting, if necessary or appropriate, **FOR** the election of the three directors identified herein, **FOR** the ratification of the appointment of Grant Thornton LLP as our independent public accountants for the 2011 fiscal year, **FOR** the Say on Pay Proposal, and for **3 YEARS** with respect to the Frequency Vote on Say on Pay. Details of the business to be conducted at the Annual Meeting are given in the attached Notice of Annual Meeting and Proxy Statement. At the Annual Meeting, stockholders will have an opportunity to comment and ask appropriate questions.

The Proposal to Sell the ICS Business and the Name Change Charter Amendment must be approved by the affirmative vote of holders of a majority of our outstanding shares of stock entitled to vote at the Annual Meeting. In connection with the Acquisition Agreement, our directors, executive officers, and certain stockholders entered into voting agreements with TeleTech, the forms of which are included as *Annex B* to the proxy statement that accompanies this letter. Pursuant to the terms of the voting agreements, each such stockholder agreed to vote all of his, her, or its shares of eLoyalty stock for the Proposal to Sell the ICS Business and the Name Change Charter Amendment. As of March 24, 2011, the record date for the Annual Meeting, these

stockholders had voting power over approximately 48.5% of our outstanding shares of stock. The Proposal to Adjourn the Annual Meeting, the ratification of the appointment of Grant Thornton LLP as the Company's independent public accountants, and the Say on Pay Proposal must each be approved by the affirmative vote of holders of a majority of shares of eLoyalty Stock outstanding and entitled to vote as of the record date and present in person or represented by proxy at the Annual Meeting. The nominees for director will be elected by a plurality of the votes cast at the Annual Meeting, meaning the nominees who receive the greatest number of votes will be elected as directors. The Frequency Vote on Say on Pay will also be determined by a plurality of the votes cast at the Annual Meeting, meaning the frequency that receives the greatest number of votes will be selected.

The completion of the proposed sale of the ICS Business is subject to the satisfaction or waiver of customary closing conditions. More information about the Proposal to Sell the ICS Business, the Name Change Charter Amendment, and the other business to be conducted at the Annual Meeting is contained in the accompanying proxy statement. We encourage you to read the accompanying proxy statement in its entirety because it describes the proposed sale and documents related to the proposed sale and related transactions and provides specific information about the Annual Meeting. You may also obtain more information about eLoyalty from documents we have filed with the Securities and Exchange Commission.

On behalf of our board of directors, we thank you for your continued support of eLoyalty. Whether or not you plan to attend the Annual Meeting, we encourage you to read the accompanying proxy statement and vote promptly. To ensure that your shares are represented at the meeting, whether or not you plan to attend the meeting in person, we urge you to submit a proxy with your voting instructions by telephone, via the Internet, or by signing, dating, and mailing your proxy card in accordance with the instructions provided on it.

Sincerely,

/s/ Kelly D. Conway  
Kelly D. Conway  
President and Chief Executive Officer

**Neither the Securities and Exchange Commission nor any state securities regulatory agency has approved or disapproved the Acquisition Agreement or the transactions contemplated thereby, passed upon the merits or fairness of the Acquisition Agreement or the transactions contemplated thereby, or passed upon the adequacy or accuracy of the disclosure in this document. Any representation to the contrary is a criminal offense.**

This proxy statement, dated April 26, 2011 is first being mailed to stockholders on or about April 29, 2011.

**eLOYALTY CORPORATION**

**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS**

**TO BE HELD MAY 19, 2011**

The Annual Meeting of eLoyalty Corporation, a Delaware corporation (referred to herein as the Company, eLoyalty, we, us, or our as the context requires), will be held at 9:00 a.m. Central Time on Thursday, May 19, 2011, at the LaQuinta Inn & Suites, 2000 S. Lakeside Drive, Bannockburn, IL 60015, for the following purposes:

1. To approve the sale of substantially all of the assets, and the assumption of certain liabilities, related to our Integrated Contact Solutions Business Unit and the eLoyalty registered trademark / trade name (together, these assets and liabilities are referred to as the ICS Business ) by eLoyalty Corporation to TeleTech as contemplated by the Acquisition Agreement between TeleTech and eLoyalty, dated as of March 17, 2011 and attached as *Annex A* to the accompanying proxy statement. We refer to this proposal as the Proposal to Sell the ICS Business ;
2. To approve an amendment to our Certificate of Incorporation (the Charter ) to change our name to Mattersight Corporation. We refer to this proposal as the Name Change Charter Amendment ;
3. To approve the adjournment of the Annual Meeting, if necessary or appropriate, to solicit additional proxies if there are insufficient votes at the time of the Annual Meeting to approve the Proposal to Sell the ICS Business and the Name Change Charter Amendment. We refer to this proposal as the Proposal to Adjourn the Annual Meeting ;
4. To elect three Class III directors to serve for an ensuing term of three years;
5. To ratify the appointment of Grant Thornton LLP as our independent public accountants for 2011;
6. To approve, by a non-binding advisory vote, our executive compensation program. We refer to this proposal as the Say on Pay Proposal ;
7. To recommend, by a non-binding advisory vote, the frequency of advisory votes on our executive compensation program. We refer to this proposal as the Frequency Vote on Say on Pay ; and
8. To transact such other business as may properly come before the Annual Meeting or any adjournments or postponements thereof.

The foregoing items of business are more fully described in the proxy statement accompanying this Notice.

Only holders of record of shares of eLoyalty Common Stock, \$0.01 par value per share ( Common Stock ), and holders of record of shares of eLoyalty 7% Series B Convertible Preferred Stock, \$0.01 par value per share ( Series B Stock ; together with the Common Stock, eLoyalty Stock ), at the close of business on March 24, 2011 (the Record Date ) may vote at the Annual Meeting. A list of the stockholders entitled to vote at the Annual Meeting will be available for inspection at eLoyalty s offices at 150 Field Drive, Suite 250, Lake Forest, Illinois, during normal business hours, for ten days prior to the Annual Meeting.

By Order of the Board of Directors,

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/s/ Christine R. Carsen  
Christine R. Carsen  
Vice President, Associate General Counsel, and Corporate Secretary

Lake Forest, Illinois

April 26, 2011

**IMPORTANT: WHETHER OR NOT YOU EXPECT TO ATTEND THE ANNUAL MEETING, PLEASE COMPLETE, DATE, AND SIGN THE PROXY CARD AND MAIL IT PROMPTLY, OR YOU MAY VOTE BY TELEPHONE OR VIA THE INTERNET BY FOLLOWING THE DIRECTIONS ON THE PROXY CARD. ANY ONE OF THESE METHODS WILL ENSURE REPRESENTATION OF YOUR SHARES AT THE ANNUAL MEETING. NO POSTAGE NEED BE AFFIXED TO THE COMPANY-PROVIDED PROXY CARD ENVELOPE IF MAILED IN THE UNITED STATES.**



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**QUESTIONS AND ANSWERS ABOUT THE PROPOSAL TO SELL THE ICS BUSINESS, THE NAME CHANGE CHARTER AMENDMENT, AND THE ANNUAL MEETING**

*The following questions and answers address briefly some questions you might have regarding the Proposal to Sell the ICS Business, the Name Change Charter Amendment and the Annual Meeting. These questions and answers might not address all questions that might be important to you as a stockholder of eLoyalty. Please refer to the more detailed information contained elsewhere in this proxy statement, the annexes to this proxy statement and the documents referred to or incorporated by reference in this proxy statement.*

**Questions and Answers about the Proposal to Sell the ICS Business**

**What is the proposed transaction?**

The proposed transaction is the sale of substantially all of the assets, and the assumption of certain liabilities, related to our Integrated Contact Solutions Business Unit, including the eLoyalty registered trademark / trade name, pursuant to the Acquisition Agreement, dated as of March 17, 2011, by and between eLoyalty and TeleTech. These assets and liabilities are referred to as the ICS Business.

**Why did we agree to sell the ICS Business?**

In reaching its determination to enter into the Acquisition Agreement and approve the sale of the ICS Business, our board of directors consulted with our management and our legal and financial advisors and considered a number of factors. After careful evaluation of the potential benefits, negative factors, and other material considerations relating to the sale of the ICS Business and the Acquisition Agreement, our board of directors concluded that the sale of the ICS Business and entering into the Acquisition Agreement are advisable, fair to, and in the best interests of, eLoyalty and its stockholders. See *PROPOSAL #1: PROPOSAL TO SELL THE ICS BUSINESS Reasons for the Sale of the ICS Business*.

**Have any stockholders already agreed to approve the Proposal to Sell the ICS Business?**

Yes. The Company's directors, executive officers and certain stockholders, who, as of the Record Date, collectively had voting power over approximately 48.5% of the issued and outstanding shares of eLoyalty Stock, entered into voting agreements with TeleTech. Under the voting agreements, unless the Acquisition Agreement is terminated, including in connection with our receipt of a superior proposal as further described under *PROPOSAL #1: PROPOSAL TO SELL THE ICS BUSINESS Terms of the Voting Agreements*, these stockholders have agreed, subject to certain exceptions, to vote their shares for the approval of the Proposal to Sell the ICS Business.

**When is the sale of the ICS Business expected to be completed?**

Unless the Acquisition Agreement is terminated prior to the Annual Meeting, the sale of the ICS Business will occur as soon as practicable after the Annual Meeting, assuming all of the conditions in the Acquisition Agreement have been satisfied or waived. We and TeleTech are working toward satisfying the conditions to closing and completing the sale of the ICS Business as soon as reasonably practicable.

**What will happen after the Proposal to Sell the ICS Business is approved by our stockholders?**

After the Proposal to Sell the ICS Business is approved by our stockholders at the Annual Meeting and other conditions to the sale are satisfied, we will sell the ICS Business to TeleTech and continue to operate our Behavioral Analytics Service Business Unit, which will be our only remaining business. We will remain a public company.

**What will happen if the Acquisition Agreement is terminated?**

If the Acquisition Agreement is terminated, then the sale of the ICS Business will not be completed as currently contemplated. In such event, we would continue to conduct our business as currently conducted and would evaluate all available strategic alternatives. Under specified circumstances, eLoyalty might be required to pay TeleTech \$1.5 million as a termination fee and/or up to \$500,000 in reasonable out-of-pocket expenses in the event that the transactions contemplated by the Acquisition Agreement are not completed. See *PROPOSAL #1: PROPOSAL TO SELL THE ICS BUSINESS Termination Fees*.

**What will happen to my shares of eLoyalty Stock if the sale of the ICS Business is completed?**

A stockholder who owns shares of eLoyalty Stock immediately prior to the closing of the sale of the ICS Business, subject to any actions taken solely by the stockholder, will continue to hold the same number of shares immediately following the closing. As a result of the proposed sale, the holders of Series B Stock will be entitled to receive a liquidation preference of approximately \$19.4 million before any dividends or distributions can be made to the holders of Common Stock. Of this amount, we currently expect to pay approximately \$1.3 million, representing dividends in arrears, immediately following the closing. We also intend to assess from time to time after the closing whether we have available funds for a full or partial distribution of the remaining liquidation preference to the holders of Series B Stock. See *PROPOSAL #1: PROPOSAL TO SELL THE ICS BUSINESS Post-Closing Business and Proceeds from the Sale of the ICS Business*.

**How was the purchase price for the ICS Business determined?**

The purchase price for the ICS Business was negotiated between our board of directors and our representatives and representatives of TeleTech over a period of several months. Our board of directors selected the proposed sale of the ICS Business to TeleTech among the alternatives we were pursuing, among other reasons, because our board of directors believed it to be in the best interests of eLoyalty and its stockholders, offered the best value, and was likely to be completed. See *PROPOSAL #1: PROPOSAL TO SELL THE ICS BUSINESS Background of the Sale of the ICS Business*.

**Questions and Answers about the Name Change Charter Amendment**

**What is the proposed Name Change Charter Amendment?**

The proposed Name Change Charter Amendment would change our name from eLoyalty Corporation to Mattersight Corporation upon the closing of the sale of the ICS Business.

**Why are we asking for a stockholder vote for the Name Change Charter Amendment?**

Delaware law requires that we obtain approval from our stockholders in order to amend our Charter.

**Why are we changing our name?**

We believe that the name Mattersight Corporation more closely aligns our public identity with our Behavioral Analytics Service Business Unit, which will be our only remaining business and the sole focus of our board of directors and management after the sale of the ICS Business. Also, we are selling the rights to use the name and registered trademark eLoyalty to TeleTech. Therefore, after the closing of the sale of the ICS Business, we will be unable to continue using the name eLoyalty, subject to limited exceptions, without TeleTech's consent.

**What effect will the Name Change Charter Amendment have upon currently outstanding stock?**

If the Name Change Charter Amendment is approved by the stockholders and becomes effective, the rights of stockholders holding certificated shares under currently outstanding stock certificates and the number of shares represented by those certificates will remain unchanged. The name change will not affect the validity or

transferability of any currently outstanding stock certificates that bear the name eLoyalty Corporation, nor will it be necessary for stockholders with certificated shares to surrender or exchange any stock certificates they currently hold as a result of the name change. Uncertificated shares currently held in direct registration accounts and any new stock certificates that are issued after the name change becomes effective will bear the name Mattersight Corporation. Finally, if the Name Change Charter Amendment is approved, we expect that the trading symbol for our Common Stock on the Nasdaq Global Market will be changed from ELOY to MATR.

**Is the Name Change Charter Amendment conditioned on the closing of the sale of the ICS Business?**

Yes. The Name Change Charter Amendment is conditioned upon the closing of the sale of the ICS Business. If the closing of the sale of the ICS Business does not occur, then we will not file the Name Change Charter Amendment with the Secretary of State of the State of Delaware to change our name.

**Have any stockholders already agreed to approve the Name Change Charter Amendment?**

Yes. Pursuant to the voting agreement described above, the Company's directors, executive officers and certain stockholders, who, as of the Record Date, collectively had voting power over approximately 48.5% of the issued and outstanding shares of eLoyalty Stock, have agreed to vote the shares of eLoyalty Stock owned by them in favor of the Name Change Charter Amendment. See *PROPOSAL #1: PROPOSAL TO SELL THE ICS BUSINESS Terms of the Voting Agreements*.

**Questions and Answers about the Annual Meeting**

**Why did you send me this proxy statement?**

You are receiving a proxy statement and proxy card because you owned shares of eLoyalty Stock as of the Record Date. This proxy statement and proxy card relate to our Annual Meeting (and any adjournment thereof) and describe the matters on which we would like you, as a stockholder, to vote. This proxy statement summarizes information you need to know to vote at the Annual Meeting. All stockholders are cordially invited to attend the Annual Meeting in person. However, you do not need to attend the meeting to vote your shares. Instead, you may simply vote by proxy through the Internet, by telephone, or by mail.

We included the Proposal to Sell the ICS Business in this proxy statement because we are required to obtain the approval of our stockholders in connection with a sale of all or substantially all of our assets. We believe that the sale of the ICS Business likely constitutes a sale of substantially all of our assets under Delaware law, as revenue from the ICS Business accounted for \$60 million, or 68%, of our total revenues of \$88 million for the fiscal year ended January 1, 2011. In addition, the ICS Business has historically produced net income while our remaining Behavioral Analytics Service Business Unit has operated at a loss.

**When and where will the Annual Meeting be held?**

The Annual Meeting will be held at the LaQuinta Inn & Suites, 2000 S. Lakeside Drive, Bannockburn, IL 60015, on Thursday, May 19, 2011 at 9:00 a.m. Central Time.

**What is the Proposal to Adjourn the Annual Meeting?**

The Proposal to Adjourn the Annual Meeting would permit us to adjourn or postpone the Annual Meeting if a quorum is present. A quorum will be present at the Annual Meeting if the holders of a majority of the shares of eLoyalty Stock outstanding and entitled to vote generally in the election of directors on the Record Date are present, either in person or by proxy. We would adjourn the Annual Meeting for the purpose of soliciting additional proxies in the event that, at the Annual Meeting, the affirmative vote in favor of the Proposal to Sell the ICS Business and the Name Change Charter Amendment is less than a majority of shares of eLoyalty Stock outstanding and entitled to vote at the Annual Meeting. Holders of approximately 48.5% of the issued and outstanding shares of eLoyalty Stock have agreed to vote the shares of eLoyalty Stock owned by them in favor of the Proposal to Sell the ICS Business and the Name Change Charter Amendment.

**What will happen if the Proposal to Adjourn the Annual Meeting is approved by our stockholders?**

If the Proposal to Adjourn the Annual Meeting is approved and the Proposal to Sell the ICS Business and the Name Change Charter Amendment are not approved at the Annual Meeting while a quorum is present, then we will be able to adjourn or postpone the Annual Meeting for the purpose of soliciting additional proxies to approve the Proposal to Sell the ICS Business and the Name Change Charter Amendment. If you have previously submitted a proxy on the proposals discussed in this proxy statement and wish to revoke it upon adjournment or postponement of the Annual Meeting, you may do so.

**Am I entitled to appraisal or dissenters' rights in connection with the Proposal to Sell the ICS Business, the Name Change Charter Amendment, or the Proposal to Adjourn the Annual Meeting?**

No. The General Corporation Law of the State of Delaware does not provide for stockholder appraisal or dissenters' rights in connection with these types of actions.

**What will I be asked to vote upon at the Annual Meeting?**

At the Annual Meeting, you will be asked to vote upon the following:

to approve the Proposal to Sell the ICS Business;

to approve the Name Change Charter Amendment;

to approve the Proposal to Adjourn the Annual Meeting, if necessary or appropriate;

to elect three Class III directors to serve for an ensuing term of three years;

to ratify the appointment of Grant Thornton LLP as our independent public accountants for 2011;

to approve, on an advisory basis, the Say on Pay Proposal; and

to elect, on an advisory basis, the frequency of advisory votes on our executive compensation program.

**How does our board of directors recommend that our stockholders vote?**

After careful consideration, our board of directors recommends that you vote:

**FOR** the Proposal to Sell the ICS Business;

**FOR** the Name Change Charter Amendment;

**FOR** the Proposal to Adjourn the Annual Meeting;

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**FOR** the election of the three directors identified herein;

**FOR** the ratification of the appointment of Grant Thornton LLP as our independent public accountants for the 2011 fiscal year;

**FOR** the Say on Pay Proposal; and

For **3 YEARS** with respect to the Frequency Vote on Say on Pay.

You should read *PROPOSAL #1: PROPOSAL TO SELL THE ICS BUSINESS Reasons for the Sale of the ICS Business* for a discussion of the factors that our board of directors considered in deciding to recommend the approval of the sale of the ICS Business. In addition, in considering the recommendation of our board of directors with respect to the sale of the ICS Business, you should be aware that some of our directors and executive officers have interests in the transaction that are different from, or in addition to, the interests of our stockholders generally. See

*PROPOSAL #1: PROPOSAL TO SELL THE ICS BUSINESS Interests of Certain Persons in the Sale of the ICS Business.*

**Who is entitled to vote at the Annual Meeting?**

You are entitled to vote if you owned shares of eLoyalty Stock as of the close of business on March 24, 2011 (the Record Date). Each share of eLoyalty Stock is entitled to one vote and there is no cumulative voting. As of the Record Date we had 19,162,325 shares of eLoyalty Stock outstanding. Both Delaware law and our bylaws require our board of directors to establish a record date in order to determine who is entitled to receive notice of the Annual Meeting, and to attend and vote at the Annual Meeting and any continuations, adjournments or postponements of the meeting.

**How many votes must be present to hold the Annual Meeting?**

In order to conduct the business of the Annual Meeting, we must have a quorum. A quorum requires the presence, in person or by proxy, of a majority of the 19,162,325 shares of eLoyalty Stock outstanding and entitled to vote generally in the election of directors on the Record Date. Your shares are counted as present if you attend the meeting and vote in person or if you properly return a proxy over the Internet, by telephone or by mail. Abstentions will be counted for purposes of establishing a quorum. See *THE ANNUAL MEETING Record Date and Quorum*.

**What vote is required to approve each of the proposals?**

The Proposal to Sell the ICS Business and the Name Change Charter Amendment must be approved by the affirmative vote of holders of a majority of the shares of eLoyalty Stock outstanding and entitled to vote as of the close of business on the Record Date. The Proposal to Adjourn the Annual Meeting, the ratification of the appointment of Grant Thornton LLP as the Company's independent public accountants, and the Say on Pay Proposal must each be approved by the affirmative vote of holders of a majority of the shares of eLoyalty Stock outstanding and entitled to vote as of the close of business on the Record Date and present in person or represented by proxy at the Annual Meeting. The nominees for director will be elected by a plurality of the votes cast at the Annual Meeting, meaning the nominees who receive the greatest number of votes will be elected as directors. The Frequency Vote on Say on Pay will also be determined by a plurality of the votes cast at the Annual Meeting, meaning the frequency that receives the greatest number of votes will be the choice of stockholders. See *THE ANNUAL MEETING Vote Required for Approval*.

**How do I vote or change my vote?**

You may vote in person at the Annual Meeting or by proxy through the Internet, by telephone, or by mail. You may revoke your proxy at any time before the voting at the Annual Meeting by: voting again at a later date by telephone or through the Internet; submitting a new proxy that is properly signed with a later date; sending a properly signed written notice of your revocation to our Corporate Secretary, at eLoyalty Corporation, 150 Field Drive, Suite 250, Lake Forest, Illinois 60045, Attention: Corporate Secretary; or voting in person at the Annual Meeting. Attendance at the Annual Meeting will not itself revoke an earlier submitted proxy. If your shares are held in street name through a broker, bank, or other nominee, then you must contact your broker, bank, or nominee to revoke your proxy. See *THE ANNUAL MEETING Voting, Proxies and Revocation*.

**If my shares are held in street name by my broker, will my broker vote my shares for me?**

Your broker or nominee is not permitted to use discretion and vote your shares on non-routine matters without your instructions. Shares that are not permitted to be voted by your broker are called broker non-votes. Without your instructions, your shares will not be voted by your broker, which will have the same effect as a vote AGAINST the Proposal to Sell the ICS Business and AGAINST the Name Change Charter Amendment. Broker non-votes will have no effect on the election of directors, the ratification of the appointment of Grant Thornton LLP as our independent public accountants for the 2011 fiscal year, the Say on Pay Proposal, or the Frequency Vote on Say on Pay. See *THE ANNUAL MEETING Vote Required for Approval*.



**How are proxies solicited?**

This proxy solicitation is being made and paid for by eLoyalty on behalf of its board of directors. Our directors, officers, and employees may solicit proxies by personal interview, mail, email, telephone, facsimile, or other means of communication. These directors, officers, and employees will not be paid additional remuneration for their efforts. We will also request brokers and other fiduciaries to forward proxy solicitation material to the beneficial owners of shares of eLoyalty Stock that the brokers and fiduciaries hold of record. Upon request, we will reimburse the brokers and other fiduciaries for their reasonable out-of-pocket expenses for doing this.

**What does it mean if I get more than one proxy card?**

If your shares are registered differently and are in more than one account, then you might receive more than one proxy card. Please complete, sign, date, and return all of the proxy cards you receive regarding the Annual Meeting to ensure that all of your shares are voted.

**How are proxies counted?**

On all matters, each share has one vote. The Proposal to Sell the ICS Business and the Name Change Charter Amendment require the affirmative vote of the holders of a majority of the shares outstanding as of the Record Date. Since the Proposal to Sell the ICS Business and the Name Change Charter Amendment require the approval of the holders of a majority of our shares outstanding as of the Record Date, both broker non-votes and abstentions would have the same effect as votes AGAINST such proposals. The Proposal to Adjourn the Annual Meeting, the ratification of the appointment of Grant Thornton LLP as the Company's independent public accountants, and the Say on Pay Proposal must each be approved by the affirmative vote of holders of a majority of shares of eLoyalty Stock outstanding and entitled to vote as of the Record Date and present in person or represented by proxy at the Annual Meeting. A failure to vote your shares of eLoyalty Stock or a broker non-vote will have no effect on the outcome of the Proposal to Adjourn the Annual Meeting, the ratification of the appointment of Grant Thornton LLP as the Company's independent public accountants, and the Say on Pay Proposal. An abstention will have the same effect as voting AGAINST the Proposal to Adjourn the Annual Meeting, the ratification of the appointment of Grant Thornton LLP as the Company's independent public accountants, and the Say on Pay Proposal. The nominees for director will be elected by a plurality of the votes cast at the Annual Meeting, meaning the nominees who receive the greatest number of votes will be elected as directors. The Frequency Vote on Say on Pay will also be determined by a plurality of the votes cast at the Annual Meeting, meaning the frequency that receives the greatest number of votes will be the choice of stockholders. With respect to the election of our directors and the Frequency Vote on Say on Pay, neither broker non-votes nor abstentions are included in the tabulation of the voting results and, therefore, do not have the effect of votes AGAINST such proposal.

**How do I obtain an additional copy of this proxy statement or copies of eLoyalty's most recent annual report on Form 10-K?**

If you would like an additional copy of this proxy statement or a copy of our annual report on Form 10-K for the fiscal year ended January 1, 2011 filed with the Securities and Exchange Commission (the SEC) on March 17, 2011, we will send you one without charge. Please either send your request in writing to Christine R. Carsen, Vice President, Associate General Counsel, and Corporate Secretary, eLoyalty Corporation, 150 Field Drive, Suite 250, Lake Forest, Illinois 60045 or call 847-582-7000.

**Who can help answer my other questions?**

If you have more questions about the sale of the ICS Business, need assistance in submitting your proxy or voting your shares, or need additional copies of the proxy statement or the enclosed proxy card, you should contact Christine R. Carsen, Vice President, Associate General Counsel, and Corporate Secretary, eLoyalty Corporation, 150 Field Drive, Suite 250, Lake Forest, Illinois 60045 or call 847-582-7000.

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**SUMMARY TERM SHEET**

*This summary, together with the question and answer section that precedes this section, highlights selected information from the proxy statement about the sale of assets, and the assumption of certain liabilities, related to our Integrated Contact Solutions Business Unit and the eLoyalty registered trademark / trade name. These assets and liabilities are referred to as the ICS Business. This summary and the question and answer section may not contain all of the information that is important to you. For a more complete description of the sale of the ICS Business, you should carefully read this proxy statement and the Acquisition Agreement attached hereto as Annex A before you vote. The location of the more detailed description of each item in this summary is provided in the parentheses listed below. See also Where You Can Obtain Additional Information on page 115.*

**Parties to the Acquisition Agreement (page 18)**

***eLoyalty Corporation***

eLoyalty is a customer interaction consulting and managed services company. We have been designing and implementing large-scale customer interaction solutions since 1990, and we possess unparalleled experience and qualifications in these application areas. We help our clients achieve breakthrough results with revolutionary analytics and advanced technologies that drive continuous business improvement. We currently operate our business through two primary business units: the Behavioral Analytics Service and Integrated Contact Solutions. The Behavioral Analytics Service Business Unit focuses on solutions that improve the reliability of call recording and applies human behavioral modeling to analyze and improve customer interactions. The Behavioral Analytics Service is primarily a hosted solution and is delivered as a managed subscription service. The Integrated Contact Solutions Business Unit focuses on helping clients realize the benefits of transitioning their contact centers to a single network infrastructure from the traditional two-network (voice network and separate data network) model. We have agreed to sell our Integrated Contact Solutions Business Unit pursuant to the Acquisition Agreement.

***TeleTech Holdings, Inc.***

TeleTech is one of the largest global providers of onshore, offshore, and work from home business process outsourcing services focusing on revenue generation, customer and enterprise management, and technology-enabled solutions. TeleTech helps Global 1000 companies enhance their strategic capabilities, improve quality and lower costs by designing, implementing and managing their critical front- and back-office processes. TeleTech provides a 24 x 7, 365 day fully integrated global solution that spans people, process, proprietary technology and infrastructure for governments and private sector clients in the automotive, broadband, cable, financial services, government, healthcare, logistics, media and entertainment, retail, technology, travel, and wireline and wireless communication industries.

**The Purchase and Sale of the ICS Business (page 39)**

Pursuant to the terms of the Acquisition Agreement, dated as of March 17, 2011, by and between eLoyalty and TeleTech, we have agreed to sell substantially all of the assets related to the ICS Business, including the eLoyalty registered trademark / trade name, to TeleTech.

**Purchase Price (page 40)**

If the sale of the ICS Business pursuant to the Acquisition Agreement is completed, then TeleTech will pay us an aggregate cash purchase price of \$40.85 million, subject to adjustment as set forth in the Acquisition Agreement. Of the total purchase price, \$1.5 million will be funded into an escrow account to satisfy our obligations under any indemnity claims that may be made by TeleTech. The purchase price is subject to adjustment based on a managed services amount (generally, unearned revenue less prepaid expenses) as of the closing date, which we will be required to transfer with the ICS Business. The purchase price will also be adjusted to the extent the ICS Business's working capital ratio (generally, the ratio of current assets, excluding prepaid-cost deferrals, to current liabilities, excluding unearned revenue) is greater or less than 1.21 as of the closing date.

**Post-Closing Business and Proceeds from the Sale of the ICS Business (page 36)**

After giving effect to our payment of estimated transaction fees and expenses and before giving effect to purchase price adjustments set forth in the Acquisition Agreement, we estimate that the net cash proceeds from our sale of the ICS Business will be approximately \$38.9 million. The purchase price adjustments set forth in the Acquisition Agreement will cause the actual amount of net cash proceeds to vary from this estimate. The purchase price adjustments will require that we transfer cash with the ICS Business at closing representing certain net managed services amounts, which amounts were equal to approximately \$11.7 million as of January 1, 2011.

We intend to use a portion of the net proceeds from the sale of the ICS Business to support our Behavioral Analytics Service Business Unit, which will be our only remaining business. As a result of the proposed sale, the holders of Series B Stock will be entitled to receive a liquidation preference of approximately \$19.4 million before any dividends or distributions can be made to the holders of Common Stock. Of this amount, we currently expect to pay approximately \$1.3 million, representing dividends in arrears, immediately following the closing. We also intend to assess from time to time after the closing whether we have available funds for a full or partial distribution of the remaining liquidation preference to the holders of the Series B Stock.

Technology Crossover Ventures (TCV), the holder of a majority of the outstanding Series B Stock, has expressed its position that a cash payment equal to the full amount of the liquidation preference is due to the holders of Series B Stock immediately upon the closing of the proposed sale. Based on the advice of our legal counsel, we do not agree with TCV's position. On April 26, 2011, we entered into an agreement with TCV providing that, subject to certain conditions, we and TCV will submit to a final and binding arbitration in the Court of Chancery of the State of Delaware no later than 45 days following the closing of the sale of the ICS Business in the event that the parties have not reached a resolution prior to such time. During the pendency of any arbitration, we agreed to maintain cash and cash equivalents in an amount sufficient to pay in full the liquidation preference on the Series B Stock. See *PROPOSAL #1: PROPOSAL TO SELL THE ICS BUSINESS Post-Closing Business and Proceeds from the Sale of the ICS Business*.

**Vote Required for Approval of the Proposal to Sell the ICS Business, the Name Change Charter Amendment, and Adjournment of the Annual Meeting (page 15)**

The Proposal to Sell the ICS Business and the Name Change Charter Amendment must be approved by the affirmative vote of the holders of a majority of shares of eLoyalty Stock outstanding and entitled to vote at the Annual Meeting. The Proposal to Adjourn the Annual Meeting must be approved by the affirmative vote of the holders of a majority of shares of eLoyalty Stock outstanding and entitled to vote and present at the Annual Meeting. See *THE ANNUAL MEETING Vote Required for Approval*.

**The Annual Meeting (pages 3, 14)**

See *Questions and Answers about the Annual Meeting* and *THE ANNUAL MEETING*.

**Reasons for the Sale of the ICS Business (page 26); Recommendation of Our Board of Directors (page 53)**

In reaching its determination to enter into the Acquisition Agreement and approve the sale of the ICS Business, our board of directors consulted with our management and our legal and financial advisors and considered a number of factors, including possible alternatives to the sale, the sale process and terms, and the opinion of NeXtAdvisors, LLC, a unit of North Point Advisors LLC, a member of FINRA (NeXtAdvisors), our financial advisor. After careful evaluation of the potential benefits, negative factors, and other material

considerations relating to the sale of the ICS Business and the Acquisition Agreement, our board of directors concluded that the sale of the ICS Business and our entering into the Acquisition Agreement are advisable, fair to, and in the best interests of, eLoyalty and our stockholders.

**Our board of directors recommends that you vote FOR the approval of the Proposal to Sell the ICS Business, FOR the Name Change Charter Amendment, and FOR the Proposal to Adjourn the Annual Meeting.**

**Interests of Certain Persons in the Sale of the ICS Business (page 38)**

In considering the recommendation of our board of directors with respect to the Acquisition Agreement, our stockholders should be aware that some of our directors and executive officers have interests in the sale of the ICS Business that are different from, or in addition to, the interests of our stockholders generally. See *PROPOSAL #1: PROPOSAL TO SELL THE ICS BUSINESS Interests of Certain Persons in the Sale of the ICS Business*.

**Opinion of NeXtAdvisors (page 30)**

On March 11, 2011, NeXtAdvisors delivered its oral opinion, which opinion was subsequently confirmed in writing that day, to our board of directors to the effect that, as of such date and based upon the assumptions made, matters considered, and limits of such review, in each case as set forth in its opinion, the consideration to be received by eLoyalty pursuant to the proposed sale of the ICS Business to TeleTech was fair from a financial point of view to eLoyalty.

The full text of the written opinion of NeXtAdvisors, dated as of March 11, 2011, which sets forth the assumptions made, matters considered, and limits on the scope of the review undertaken in connection with the opinion, is attached as *Annex C* to this proxy statement. The summary of NeXtAdvisors' opinion contained in this proxy statement is qualified by reference to the full text of NeXtAdvisors' opinion, and you are encouraged to carefully read the opinion in its entirety. NeXtAdvisors' opinion was delivered to our board of directors for its use and benefit in its evaluation of the sale of the ICS Business to TeleTech, does not address the merits of the underlying decision by eLoyalty to sell the ICS Business, and does not constitute a recommendation to any eLoyalty stockholder as to how to vote on the Proposal to Sell the ICS Business.

**Governmental and Regulatory Approvals (page 35)**

Neither eLoyalty nor TeleTech is aware of any regulatory approvals required to be obtained, or waiting periods to expire, to complete the sale of the ICS Business to TeleTech. If the parties discover that approvals or waiting periods are necessary, then they will seek to obtain or comply with them.

**Certain U.S. Income Tax Consequences (page 35)**

The sale of the ICS Business should not result in any current United States federal income tax consequences to our stockholders. We expect to recognize a gain for United States federal income tax purposes on the sale of the ICS Business. However, based on the results of an analysis that we have undertaken with assistance of our tax advisors, we expect that for United States federal income tax purposes all or substantially all of the taxable gain resulting from the sale of the ICS Business will be offset by available net operating losses. See *PROPOSAL #1: PROPOSAL TO SELL THE ICS BUSINESS Certain U.S. Income Tax Consequences*.

**Nature of Our Business Following the Sale of the ICS Business (pages 36, 73)**

Following the sale of the ICS Business and the effectiveness of the Name Change Charter Amendment, we will continue to be a public company operating under the name Mattersight Corporation, and our Behavioral Analytics Service Business Unit will account for all of our revenues.

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**Terms of the Acquisition Agreement (page 39)**

In the Acquisition Agreement, we make representations and warranties and have agreed to covenants, indemnification obligations, and other customary provisions. You are encouraged to read carefully the Acquisition Agreement in its entirety, a copy of which is attached hereto as *Annex A*, and *PROPOSAL #1: PROPOSAL TO SELL THE ICS BUSINESS Terms of the Acquisition Agreement*.

**Termination of the Acquisition Agreement (page 49)**

The Acquisition Agreement may be terminated by either party if the sale of the ICS Business is not completed on or before July 3, 2011 or upon the issuance of an order or injunction by any governmental entity. TeleTech may terminate the Acquisition Agreement if (i) we do not receive stockholder approval of the Sale of the ICS Business by June 15, 2011, (ii) our board of directors withdraws its recommendation that our stockholders approve the Acquisition Agreement, (iii) we willfully and materially breach any of our obligations with respect to alternative acquisition proposals, (iv) we intentionally or recklessly breach any representation or warranty or covenant in the Acquisition Agreement such that conditions to TeleTech's obligations to close are not met; or (v) any information we disclose to TeleTech after signing the Acquisition Agreement could reasonably be expected to give rise to a material adverse effect. We may terminate the Acquisition Agreement if (a) we enter into a third-party acquisition agreement that provides for a superior proposal (as defined in *PROPOSAL #1: PROPOSAL TO SELL THE ICS BUSINESS Terms of the Acquisition Agreement Covenants and Agreements*) prior to receipt of our stockholders' approval or (b) TeleTech breaches any representation or warranty or covenant in the Acquisition Agreement such that conditions to our obligations to close are not met. See *PROPOSAL #1: PROPOSAL TO SELL THE ICS BUSINESS Terms of the Acquisition Agreement Covenants and Agreements*.

**Termination Fee and Expense Reimbursement (page 50)**

If the Acquisition Agreement is terminated under circumstances described in detail elsewhere in this proxy statement and in the Acquisition Agreement, then we will be obligated to pay TeleTech \$1.5 million as a termination fee and/or up to \$500,000 in reasonable out-of-pocket expenses incurred in connection with the proposed sale of the ICS Business. See *PROPOSAL #1: PROPOSAL TO SELL THE ICS BUSINESS Terms of the Acquisition Agreement Termination Fees*

**Restrictions on Solicitation of Other Offers (page 45)**

The Acquisition Agreement provides that, from the date of the Acquisition Agreement until the earlier of the closing date or the termination of the Acquisition Agreement in accordance with its terms, eLoyalty may not, directly or indirectly, initiate, solicit, encourage, or participate in any discussions regarding an acquisition proposal (as defined in *PROPOSAL #1: PROPOSAL TO SELL THE ICS BUSINESS Terms of the Acquisition Agreement Covenants and Agreements*) by a party other than TeleTech, subject to the exceptions described below. If, however, we receive an unsolicited acquisition proposal that our board of directors determines in good faith after consultation with our legal and financial advisors is, or is reasonably likely to result in, a superior proposal (as defined in *PROPOSAL #1: PROPOSAL TO SELL THE ICS BUSINESS Terms of the Acquisition Agreement Covenants and Agreements*) from a party other than TeleTech prior to receipt of our stockholders' approval of the Proposal to Sell the ICS Business, and such offer does not arise from a breach of the restrictions on solicitation of other offers, we may furnish information concerning our business, properties, or assets pursuant to a confidentiality agreement and negotiate and participate in discussions and negotiations concerning an acquisition proposal. Further, prior to receipt of our stockholders' approval of the Proposal to Sell the ICS Business, our board of directors may withdraw or modify its recommendation to vote for *PROPOSAL #1: PROPOSAL TO SELL THE ICS BUSINESS* if our board determines in good faith, after receiving advice of legal and financial advisors and taking into account any binding offer by TeleTech to amend the terms of the Acquisition Agreement and other factors related to the certainty of the acquisition proposal, that the failure to take such action would be reasonably likely to constitute a breach by our board of its fiduciary duties to our stockholders under Delaware law. See *PROPOSAL #1: PROPOSAL TO SELL THE ICS BUSINESS Terms of the Acquisition Agreement Covenants and Agreements*.

**Conditions to Closing (page 48)**

The consummation of the transactions contemplated by the Acquisition Agreement is subject to, among other things, the approval of our stockholders described above, receipt of certain required third-party consents and approvals, each party's respective representations and warranties in the Acquisition Agreement being true and correct as of the closing date to the standards described in the Acquisition Agreement, each party's performance in all material respects of its obligations required to be performed under the Acquisition Agreement on or prior to the closing date, EBITDA for the ICS Business for the twelve month period ended on March 31, 2011 exceeding \$8,000,000, and each party's delivery to the other party of all applicable transaction documents pursuant to the Acquisition Agreement. See *PROPOSAL #1: PROPOSAL TO SELL THE ICS BUSINESS Terms of the Acquisition Agreement Conditions to the Sale of the ICS Business*.

**Indemnification (page 51)**

The Acquisition Agreement provides that, subject to specified exceptions, eLoyalty and TeleTech will be liable to each other for breaches of certain representations and warranties as set forth in the Acquisition Agreement if, and only to the extent, aggregate damages for such breaches exceed \$200,000. Subject to certain exceptions set forth in the Acquisition Agreement, each party's indemnification obligations are subject to a cap of \$2.0 million. To provide a partial fund against which TeleTech may assert an indemnification claim pursuant to the foregoing, \$1.5 million of the purchase price will be put in escrow and disbursed to us on the six month anniversary of the closing. In addition, we are required to indemnify TeleTech for any breach or failure by eLoyalty to perform any of the covenants of eLoyalty contained in the Acquisition Agreement, any liabilities arising from, or in connection with, any retained liability or any excluded asset, or from the noncompliance with any legal requirement related to fraud, intentional misrepresentation, or criminal acts committed by or on our behalf on or prior to the closing date.

Except as otherwise provided in the Acquisition Agreement, the indemnification provisions set forth in the Acquisition Agreement constitute the sole and exclusive remedy available to eLoyalty and TeleTech with respect to breaches of the representations, warranties, and covenants set forth in the Acquisition Agreement (other than each party's right to specific performance or injunctive relief or in cases of other willful misconduct).

**CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS**

Statements in this proxy statement that are not historical facts (such as those related to the closing of the transactions contemplated by the Acquisition Agreement, our intended operations after the closing, and our use of proceeds from the sale of the ICS Business) are forward-looking statements that are made pursuant to the safe harbor provisions of Section 27A of the Securities Act of 1933, as amended (the Securities Act ), and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. These forward-looking statements, which may be identified by use of words such as plan, may, might, believe, expect, intend, could, would, should, and other words with similar meaning, in connection with any discussion of our prospects, financial statements, business, financial condition, revenues, results of operations, or liquidity, involve risks and uncertainties that could cause actual results to differ materially from those described in the forward-looking statements. In addition to other factors and matters contained or incorporated in this document, important factors that could cause actual results or events to differ materially from those indicated by such forward-looking statements include, among other things:

the occurrence of any event, change, or other circumstance that could give rise to the termination of the Acquisition Agreement;

the inability to complete the transactions contemplated by the Acquisition Agreement due to the failure to satisfy the conditions to the completion of the transactions contemplated by the Acquisition Agreement, including the receipt of stockholder approval;

the failure of the transactions contemplated by the Acquisition Agreement to close for any other reason;

the parties' ability to meet expectations regarding the timing for completion of the transactions contemplated by the Acquisition Agreement;

the retention of key employees at eLoyalty as a result of the transactions contemplated by the Acquisition Agreement;

business uncertainty and contractual restrictions during the pendency of the transactions contemplated by the Acquisition Agreement;

the possible effect of the announcement of the Acquisition Agreement and the transactions contemplated thereby on our customer and supplier relationships, operating results, and business generally;

the outcome of any legal proceedings that may be instituted against eLoyalty and others related to the Acquisition Agreement or the transactions contemplated thereby, including any dispute relating to the manner and time period in which the Company will satisfy obligations relating to the Series B Stock;

the inability of the ICS Business to achieve meaningful growth and sustainable profitability;

the amount of the purchase price adjustments, costs, fees, expenses and charges relating to the sale of the ICS Business;

the failure to operate our Behavioral Analytics Service Business Unit successfully;

changes in global or domestic economic conditions; and

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competition generally and the increasingly competitive nature of our industry.

In addition, we are subject to risks and uncertainties and other factors detailed in our annual report on Form 10-K for the fiscal year ended January 1, 2011, filed with the SEC on March 17, 2011, which should be read in conjunction with this proxy statement. See *Where You Can Obtain Additional Information* on page 115. Many of the factors that will impact the completion of the proposed transactions are beyond our ability to control or predict.



In light of the significant uncertainties inherent in the forward-looking statements contained in this proxy statement, readers should not place undue reliance on forward-looking statements. We cannot guarantee any future results, levels of activity, performance, or achievements. The statements made in this proxy statement represent our views as of the date of this proxy statement, and it should not be assumed that the statements made in this proxy statement remain accurate as of any future date. Moreover, we assume no obligation to update forward-looking statements, except as may be required by law.

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## THE ANNUAL MEETING

### Time, Place, and Purpose of the Annual Meeting

This proxy statement is being furnished to our stockholders as part of the solicitation of proxies by our board of directors for use at the Annual Meeting to be held at the LaQuinta Inn & Suites, 2000 S. Lakeside Drive, Bannockburn, IL 60015 on Thursday, May 19, 2011, at 9:00 a.m. Central Time, or at any postponement or adjournment thereof. The proxy materials, together with a copy of eLoyalty's Annual Report, are first being mailed to our stockholders beginning on or about April 29, 2011.

The purpose of the Annual Meeting is for our stockholders to consider and vote upon the Proposal to Sell the ICS Business, the Name Change Charter Amendment, the Proposal to Adjourn the Annual Meeting (if necessary or appropriate), the election of three Class III directors to serve for an ensuing term of three years, the ratification of the appointment of Grant Thornton LLP as our independent public accountants for 2011, the Say on Pay Proposal, and the Frequency Vote on Say on Pay.

### Recommendation of Our Board of Directors

Our board of directors, after careful consideration, has approved the Acquisition Agreement and determined that the sale of the ICS Business is advisable, fair to, and in the best interests of, eLoyalty and our stockholders. Our board of directors recommends that you vote **FOR** the Proposal to Sell the ICS Business, **FOR** the Name Change Charter Amendment, **FOR** the Proposal to Adjourn the Annual Meeting, if necessary or appropriate, for the purpose of soliciting additional proxies, **FOR** the election of the three directors identified herein, **FOR** the ratification of the appointment of Grant Thornton LLP as our independent public accountants for the 2011 fiscal year, **FOR** the Say on Pay Proposal, and for **3 YEARS** with respect to the Frequency Vote on Say on Pay. For a discussion of the material factors considered by our board of directors in reaching its conclusions regarding the sale of the ICS Business, see *PROPOSAL #1: PROPOSAL TO SELL THE ICS BUSINESS Reasons for the Sale of the ICS Business*.

### Record Date and Quorum

Only holders of record of shares of eLoyalty Common Stock, \$0.01 par value per share ( Common Stock ), and holders of record of shares of eLoyalty 7% Series B Convertible Preferred Stock, \$0.01 par value per share ( Series B Stock ; together with the Common Stock, eLoyalty Stock ), at the close of business on March 24, 2011 (the Record Date ) may vote at the Annual Meeting. On the Record Date, 19,162,325 shares of eLoyalty Stock, comprising 15,613,247 shares of Common Stock and 3,549,078 shares of Series B Stock, were outstanding and entitled to be voted at the Annual Meeting. Each share of eLoyalty Stock entitles the holder to one vote and both classes of eLoyalty Stock will vote together as a single class on (i) the Proposal to Sell the ICS Business, (ii) the Name Change Charter Amendment, (iii) the Proposal to Adjourn the Annual Meeting (if necessary or appropriate), (iv) the election of three Class III directors to serve for an ensuing term of three years, (v) the ratification of the appointment of Grant Thornton LLP as our independent public accountants for 2011, (vi) the Say on Pay Proposal, and (vii) the Frequency Vote on Say on Pay.

A quorum is necessary to hold a valid Annual Meeting. A quorum will be present at the Annual Meeting if the holders of a majority of the shares of eLoyalty Stock outstanding and entitled to vote generally in the election of directors on the Record Date are present, either in person or by proxy. Abstentions are counted for purposes of a quorum. Without your instructions, your broker or nominee is not permitted to use discretion and vote your shares on non-routine matters, such as the election of directors. Therefore, if you do not provide your broker or nominee instructions with respect to the election of directors, your shares will not be counted for purposes of determining the presence or absence of a quorum for the transaction of all business. If a quorum is not present at the Annual Meeting or if there are insufficient votes to approve the Proposal to Sell the ICS Business and the Name Change Charter Amendment (but sufficient votes to approve the Proposal to Adjourn the Annual Meeting), then the Annual Meeting will be adjourned or postponed to solicit additional proxies.

### **Routine vs. Non-Routine Matters**

The ratification of the appointment of Grant Thornton LLP as our independent public accountants for 2011 is considered to be a routine matter under applicable rules. A broker may generally vote on routine matters, and therefore there should be no broker non-votes in connection with this item. The Proposal to Sell the ICS Business, the Name Change Charter Amendment, the Proposal to Adjourn the Meeting, the election of directors, the Say on Pay Proposal, and the Frequency Vote on Say on Pay are considered to be non-routine matters under applicable rules. Because a broker cannot vote without instructions on non-routine matters, there may be broker non-votes on these Items.

### **Vote Required for Approval**

The Proposal to Sell the ICS Business and the Name Change Charter Amendment must be approved by the affirmative vote of holders of a majority of shares of eLoyalty Stock outstanding as of the Record Date. For the Proposal to Sell the ICS Business and the Name Change Charter Amendment, you may vote **FOR** or **AGAINST** or you may **ABSTAIN**. Because the Proposal to Sell the ICS Business and the Name Change Charter Amendment require the approval of the holders of a majority of our shares outstanding as of the Record Date, both broker non-votes and abstentions would have the same effect as votes **AGAINST** such proposals.

The Proposal to Adjourn the Annual Meeting, the ratification of the appointment of Grant Thornton LLP as the Company's independent public accountants, and the Say on Pay Proposal must each be approved by the affirmative vote of holders of a majority of shares of eLoyalty Stock outstanding and entitled to vote as of the Record Date and present in person or represented by proxy at the Annual Meeting. A failure to vote your shares of eLoyalty Stock or a broker non-vote will have no effect on the outcome of the Proposal to Adjourn the Annual Meeting, the ratification of the appointment of Grant Thornton LLP as the Company's independent public accountants, and the Say on Pay Proposal. An abstention will have the same effect as voting **AGAINST** the Proposal to Adjourn the Annual Meeting, the ratification of the appointment of Grant Thornton LLP as the Company's independent public accountants, and the Say on Pay Proposal.

Our organizational documents do not provide for cumulative voting for directors. Therefore, the nominees for director will be elected by a plurality of the votes cast at the Annual Meeting. This means that the nominees for the three director seats who receive the most affirmative votes of shares outstanding and entitled to vote as of the Record Date and present in person or represented by proxy at the Annual Meeting will be elected to serve as directors. The Frequency Vote on Say on Pay will also be determined by a plurality of the votes cast at the Annual Meeting. This means that the frequency alternative that receives the most affirmative votes of shares outstanding and entitled to vote as of the Record Date and present in person or represented by proxy at the Annual Meeting will be the choice of stockholders. With respect to the election of our directors and the Frequency Vote on Say on Pay, neither broker non-votes nor abstentions are included in the tabulation of the voting results and, therefore, do not have the effect of votes **AGAINST** such proposal.

If your shares of eLoyalty Stock are held in street name, you will receive instructions from your broker, bank, or other nominee that you must follow in order to have your shares voted. Brokers who hold shares in street name for customers are precluded from exercising their voting discretion with respect to approving non-routine matters such as the Proposal to Sell the ICS Business, the Name Change Charter Amendment, the Proposal to Adjourn the Meeting, the election of directors, the Say on Pay Proposal, and the Frequency Vote on Say on Pay and, as a result, absent specific instructions from the beneficial owner of the shares, brokers are not empowered to vote those shares, referred to generally as broker non-votes. Broker non-votes will not be counted for purposes of determining whether a quorum is present at the Annual Meeting. Broker non-votes will have the same effect as a vote **AGAINST** the Proposal to Sell the ICS Business and the Name Change Charter Amendment, but will have no effect on the Proposal to Adjourn the Annual Meeting, the election of three Class III directors to serve for an ensuing term of three years, the ratification of the appointment of Grant Thornton LLP as the Company's independent public accountants, the Say on Pay Proposal, and the Frequency Vote on Say on Pay.

In connection with the Acquisition Agreement, our directors, executive officers, and certain stockholders have entered into voting agreements with TeleTech, dated as of March 17, 2011, the forms of which are attached hereto as *Annex B*. Pursuant to the terms of the voting agreements, each such stockholder agreed to vote all of his, her, or its shares of eLoyalty Stock for the approval of the Proposal to Sell the ICS Business and the Name Change Charter Amendment. As of the Record Date, these stockholders had voting power over approximately 48.5% of eLoyalty Stock. See *PROPOSAL #1: PROPOSAL TO SELL THE ICS BUSINESS Interests of Certain Persons in the Sale of the ICS Business* and *PROPOSAL #1: PROPOSAL TO SELL THE ICS BUSINESS Terms of the Voting Agreements*.

### Voting, Proxies, and Revocation

You may vote by proxy or in person at the Annual Meeting.

*Voting in Person* If you hold shares in your name as a stockholder of record and plan to attend the Annual Meeting and wish to vote in person, you will be given a ballot at the Annual Meeting or you may give us a signed proxy card before voting is closed. If you would like to attend the Annual Meeting, please bring proof of identification with you to the Annual Meeting. Even if you plan to attend the Annual Meeting, we strongly encourage you to submit a proxy for your shares in advance as described below, so your vote will be counted if you later decide not to attend. If your shares are held in street name, which means your shares are held of record by a broker, bank, or other nominee, and you wish to vote in person at the Annual Meeting, you must bring to the Annual Meeting a proxy from the record holder of the shares (your broker, bank, or nominee) authorizing you to vote at the Annual Meeting. To do this, you should contact your broker, bank, or nominee.

*Voting by Proxy* If you are a holder of record of eLoyalty Stock (that is, you hold your stock in your own name) on the Record Date, you may submit a proxy with your voting instructions by any of the following methods:

**Through the Internet:** Go to the web address [www.proxyvote.com](http://www.proxyvote.com) and follow the instructions included with the Notice of the Annual Meeting or, if applicable, on your proxy card, at any time before 11:59 p.m. Eastern Time on May 18, 2011. Instructions are also provided on the website.

**By Telephone:** Call 1-800-690-6903 on a touch-tone telephone from anywhere within the United States or Canada at any time before 11:59 p.m. Eastern Time on May 18, 2011, and follow the instructions included with the Notice of the Annual Meeting or, if applicable, on your proxy card. Instructions are also provided by recorded telephone message.

**By Mail:** You may also complete, sign, and mail your proxy card using the instructions provided on it.

If you choose to submit your proxy with voting instructions by telephone or through the Internet, you will be required to provide your assigned control number before your proxy will be accepted. This number is included either with the Notice of the Annual Meeting or, if applicable, on your proxy card. Once you have indicated how you want to vote in accordance with the instructions provided, you will receive a confirmation that your proxy has been successfully submitted.

Properly executed proxies that do not contain specific voting instructions will be voted **FOR** the Proposal to Sell the ICS Business, **FOR** the Name Change Charter Amendment, **FOR** the Proposal to Adjourn the Annual Meeting (if necessary or appropriate), **FOR** the election of the nominees for director shown under *PROPOSAL #4: ELECTION OF DIRECTORS Nominees*, **FOR** the ratification of the appointment of Grant Thornton LLP as our independent public accountants for 2011, **FOR** the Say on Pay Proposal, and for **3 YEARS** with respect to the Frequency Vote on Say on Pay.

*Revocation of Proxy* Submitting a proxy on the enclosed form does not preclude a stockholder from voting in person at the Annual Meeting. You may revoke your proxy at any time before the voting at the Annual Meeting by any of the following methods:

voting again at a later date by telephone or through the Internet your latest voting instructions will be counted and your earlier instructions, using the same procedures, revoked;

submitting a new proxy that is properly signed with a later date;

sending a properly signed written notice of your revocation to eLoyalty's Corporate Secretary, at eLoyalty Corporation, 150 Field Drive, Suite 250, Lake Forest, Illinois 60045, Attention: Corporate Secretary; or

voting in person at the Annual Meeting. Attendance at the Annual Meeting will not itself revoke an earlier submitted proxy. If your shares are held in street name through a broker, bank, or other nominee, then you must contact your broker, bank, or nominee to revoke your proxy.

### **Adjournments and Postponements**

The Annual Meeting may be adjourned or postponed for the purpose of soliciting additional proxies to approve the Proposal to Sell the ICS Business and the Name Change Charter Amendment. Any adjournment may be made without notice, other than by an announcement made at the Annual Meeting of the time, date, and place of the adjourned meeting. Approval of the Proposal to Adjourn the Annual Meeting, if necessary or appropriate, for the purpose of soliciting additional proxies to approve the Proposal to Sell the ICS Business and the Name Change Charter Amendment requires, assuming a quorum is present, the affirmative vote of holders of a majority of shares of eLoyalty Stock outstanding and entitled to vote and present in person or represented by proxy at the Annual Meeting. If a quorum is not present at the Annual Meeting, the stockholders entitled to vote at the meeting may adjourn the meeting until a quorum is present. Any signed proxies received by us in which no voting instructions are provided on this matter will be voted FOR the Proposal to Adjourn the Annual Meeting, if necessary or appropriate, to solicit additional proxies to approve the Proposal to Sell the ICS Business and the Name Change Charter Amendment. In addition, when any meeting is convened, the presiding officer, if directed by our board of directors, may adjourn the meeting if (i) no quorum is present for the transaction of business or (ii) our board of directors determines that adjournment is necessary or appropriate to enable the stockholders to consider fully information which our board of directors determines has not been made sufficiently or timely available to stockholders or otherwise to effectively exercise their voting rights. Any adjournment or postponement of the Annual Meeting for the purpose of soliciting additional proxies will allow our stockholders who have already sent in their proxies to revoke them at any time prior to their use at the Annual Meeting as adjourned or postponed.

### **Rights of Stockholders Who Object to the Proposals**

The General Corporation Law of the State of Delaware does not provide for stockholder appraisal or dissenters' rights in connection with the types of actions contemplated under any of the proposals on the Annual Meeting agenda.

### **Solicitation of Proxies**

This proxy solicitation is being made and paid for by eLoyalty on behalf of its board of directors. Our directors, officers, and employees may solicit proxies by personal interview, mail, email, telephone, facsimile, or other means of communication. These directors, officers, and employees will not be paid additional remuneration for their efforts. We will also request brokers and other fiduciaries to forward proxy solicitation material to the beneficial owners of shares of eLoyalty Stock that the brokers and fiduciaries hold of record. Upon request, we will reimburse the brokers and other fiduciaries for their reasonable out-of-pocket expenses for doing so.

### **Questions and Additional Information**

**If you have more questions about the Proposal to Sell the ICS Business, the Name Change Charter Amendment or any other proposals on the Annual Meeting agenda, need assistance in submitting your proxy or voting your shares, or need additional copies of the proxy statement or the enclosed proxy card, you should contact Christine R. Carsen, Vice President, Associate General Counsel, and Corporate Secretary, eLoyalty Corporation, 150 Field Drive, Suite 250, Lake Forest, Illinois 60045 or call 847-582-7000.**

**PROPOSAL #1: PROPOSAL TO SELL THE ICS BUSINESS**

This section of the proxy statement describes the proposed sale of the ICS Business to TeleTech. However, we highly recommend that you also carefully read the Acquisition Agreement included as *Annex A* to this proxy statement for the complete terms of the sale of the ICS Business and other information that might be important to you.

**Parties to the Acquisition Agreement**

***eLoyalty Corporation***

eLoyalty is a customer interaction consulting and managed services company. We have been designing and implementing large-scale customer interaction solutions since 1990, and we possess unparalleled experience and qualifications in these application areas. We help our clients achieve breakthrough results with revolutionary analytics and advanced technologies that drive continuous business improvement. We currently operate our business through two primary business units: the Behavioral Analytics Service and Integrated Contact Solutions. The Behavioral Analytics Service Business Unit focuses on solutions that improve the reliability of call recording and applies human behavioral modeling to analyze and improve customer interactions. The Behavioral Analytics Service is primarily a hosted solution and is delivered as a managed subscription service. The Integrated Contact Solutions Business Unit focuses on helping clients realize the benefits of transitioning their contact centers to a single network infrastructure from the traditional two-network (voice network and separate data network) model. We have agreed to sell our Integrated Contact Solutions Business Unit pursuant to the Acquisition Agreement.

Our principal executive offices are located at 150 Field Drive, Suite 250, Lake Forest, Illinois 60045, and the telephone number at our principal executive offices is (847) 582-7000. Effective June 1, 2011, our principal executive offices will be our location at 200 South Wacker Drive, Suite 820, Chicago, Illinois 60606, and our telephone number at our principal executive offices will be (877) 356-9252.

***TeleTech Holdings, Inc.***

TeleTech is one of the largest global providers of onshore, offshore and work from home business process outsourcing services focusing on revenue generation, customer and enterprise management, and technology-enabled solutions. TeleTech helps Global 1000 companies enhance their strategic capabilities, improve quality and lower costs by designing, implementing and managing their critical front- and back-office processes. TeleTech provides a 24 x 7, 365 day fully integrated global solution that spans people, process, proprietary technology and infrastructure for governments and private sector clients in the automotive, broadband, cable, financial services, government, healthcare, logistics, media and entertainment, retail, technology, travel, and wireline and wireless communication industries.

The principal executive offices of TeleTech are located at 9197 S. Peoria Street, Englewood, Colorado 80112 and the telephone number at its principal executive offices is (303) 397-8100.

**Background of the Sale of the ICS Business**

Our board of directors reviews regularly the performance of our business and our strategies, opportunities and objectives in the markets in which we operate. In conjunction with those reviews, we assess the short- and long-term prospects of our business units and our Company as a whole. We evaluate opportunities to grow our Company organically and also inorganically, by means of mergers, acquisitions, divestitures, asset sales, and strategic alliances with other companies.

At a November 2008 meeting of our board of directors, our board began to consider the possibility of selling our Integrated Contract Solutions Business Unit, which we refer to in this proxy statement as the ICS Business. Our board believed that the lack of synergies between our two principal business units resulted in an unclear

investment proposition for both existing and new investors. Furthermore, our board believed that the sale of the ICS Business would enable the Company to focus its resources on growing the Behavioral Analytics Service Business Unit, which the Company believes has greater long-term market potential than the ICS Business. Following the meeting, our board and senior management consulted with investment banking firms to review our options.

At a February 2009 meeting of our board of directors, two investment banking firms presented their recommendations to our board and proposed valuation ranges of the ICS Business. Based on these recommendations, our board of directors determined not to proceed with a possible sale of the ICS Business at that time for several reasons, including, among other things, that the Behavioral Analytics Service Business Unit did not appear ready to operate as a standalone business. Furthermore, although the ICS Business was exhibiting improving performance, our board of directors and senior management did not believe that the Company would be able to obtain a favorable price in light of the then-current economic environment.

In October 2009, the Company received an unsolicited expression of interest from a bidder ( Party A ) for the purchase of the ICS Business. At a November 2009 meeting, our board of directors considered once again the potential benefits and effects of separating our principal business units. Our board of directors also reviewed certain updated valuation analyses for the ICS Business. At that time, our board of directors and senior management still did not believe that our Behavioral Analytics Service Business Unit was ready to operate as a standalone business. Among other things, the Behavioral Analytics Service Business Unit needed continued investment in new product development, a better developed sales function, and additional momentum from new contracts. Based on the updated valuation analyses and other factors, our board did not believe that it was an opportune time to pursue Party A s expression of interest further.

In early 2010, our board of directors and senior management again reviewed the possibility of selling the ICS Business in order to focus on our Behavioral Analytics Service Business Unit. Our board discussed strategic alternatives at length at a meeting on February 8, 2010. On one hand, the Behavioral Analytics Service Business Unit had shown increased revenues, a growing contract pipeline, a maturing sales and marketing platform, and broadened product footprint. On the other hand, the ICS Business continued to demonstrate slowing managed services growth, an overreliance on consulting services, and customer concentration risk.

At a meeting on May 5, 2010, our board of directors had another detailed discussion regarding the sale of the ICS Business. Our board of directors considered several factors in favor of divesting the ICS Business, including the following:

the ICS Business would require significant investments to move forward, including investments in management, customer interaction solutions, and intellectual property;

the ICS Business was diverting key Behavioral Analytics Service Business Unit resources;

a sale of the ICS Business would enable management to apply proceeds from the sale and other key resources to support our Behavioral Analytics Service Business Unit;

the ICS Business faces potential future strategic threats as a result of clients increasing desire for one large vendor with a broad geographic presence that can support their entire converged network; and

the ICS Business s results of operations were stabilizing, making it more attractive to potential bidders.

Our board instructed senior management to retain a financial advisor to assist it in exploring a potential sale of the ICS Business. Senior management discussed the potential engagement with various candidates over the next three weeks.

On June 8, 2010, eLoyalty retained NeXtAdvisors as its financial advisor for a sale of the ICS Business. From mid-June 2010 through mid-August 2010, our senior management and representatives of NeXtAdvisors

worked together to develop analyses of the ICS Business, an electronic data room for due diligence purposes, strategies for marketing the ICS Business, market assessments, valuation ranges, a forecasted financial model, and lists of potential buyers. In late July 2010, NeXtAdvisors began contacting potential strategic and financial buyers.

At a meeting of our board of directors held on August 4, 2010, the board discussed the anticipated benefits, risks and effects of a sale of the ICS Business. The board's principal conclusion was that eLoyalty could maximize stockholder value through a more strategic and singular focus on our Behavioral Analytics Service Business Unit following a sale of the ICS Business. Representatives of NeXtAdvisors discussed with our board the market for an enterprise asset sale, including an overview of potential buyers, the potential buyers contacted to date, valuation ranges, and strategies and timelines for the potential sale process. In addition, representatives of Winston & Strawn LLP, outside legal counsel for the Company (Winston & Strawn), made a presentation regarding the fiduciary duties of directors in the context of a sale transaction and discussed with our board of directors certain specific considerations in analyzing the sale of the ICS Business.

By the time of the meeting on August 4, 2010, NeXtAdvisors had contacted 43 buyers, nine of which executed confidentiality agreements and were granted access to the electronic data room. After the meeting, NeXtAdvisors continued to approach potential buyers and gauge interest in a potential sale of the ICS Business.

On September 1, 2010, our board of directors met to discuss the valuation of the ICS Business, optimal timing for the sale of the ICS Business, the strategy for the Behavioral Analytics Service Business Unit following the sale of the ICS Business, and potential uses of the anticipated proceeds from a sale of the ICS Business. Representatives of Winston & Strawn also discussed with our board of directors the impact that a sale of the ICS Business would have on the rights of the holders of Series B Stock. In particular, it was noted that the proposed sale would constitute a liquidation under the terms of the Certificate of Designations for the Series B Stock (the Series B Designations) and, as a result, the holders of Series B Stock would be entitled to receive a liquidation preference of approximately \$19.4 million before any dividends or distributions could be made to the holders of Common Stock. Our board of directors discussed the merits of forming a special committee to review and evaluate the potential uses of proceeds and engage in discussions with the holders of Series B Stock.

After the September 1, 2010 board meeting and continuing through mid-October 2010, NeXtAdvisors continued to approach potential buyers. In total, NeXtAdvisors approached 62 parties, including TeleTech, regarding the potential sale of the ICS Business. Of the 62 parties, 38, including nine strategic buyers and 29 financial buyers, executed confidentiality agreements and thereafter received additional information and materials relating to the ICS Business. In addition to conducting follow-up telephone calls and providing additional information at the request of the prospective bidders, representatives of NeXtAdvisors and our senior management made presentations to 12 of the parties, including six strategic buyers and six financial buyers, that had executed a confidentiality agreement.

Of the 38 parties that executed confidentiality agreements, five parties submitted non-binding initial indications of interest relating to the sale of the ICS Business (the Initial Indications). The Initial Indications, which were submitted from mid- to late-October 2010, proposed material terms and conditions relating to the sale of the ICS Business, including, without limitation, the proposed purchase price for the ICS Business (ranging from \$28 million to \$45 million), purchase price adjustments based on a managed services amount and a working capital ratio, escrow terms, financing conditions, and exclusivity.

At a meeting of our board of directors on November 3, 2010, our senior management and representatives of NeXtAdvisors updated our board as to the status of the efforts undertaken to date in connection with the proposed sale of the ICS Business as well as a summary of the material terms of the Initial Indications. After assessing the Initial Indications, our board instructed NeXtAdvisors to notify two of the parties (referred to as Party D and Party E) that had submitted Initial Indications that their bids were low in comparison to the other bidders and eLoyalty would not be pursuing further discussions with them.



From early November 2010 through mid-December 2010, our senior management and representatives of NeXtAdvisors conducted follow-up telephone calls with the three remaining bidders (referred to as Party B, Party C, and TeleTech) to confirm the terms of their Initial Indications and negotiate the purchase price and other material terms, such as the working capital adjustment, the managed services amount, the escrow amount and duration, as well as the payout of additional contingent consideration based on the forecasted financial results of the ICS Business for the first quarter of 2011.

On November 5, 2010, representatives of NeXtAdvisors had a conference call with Party B to discuss the possibility of additional contingent consideration based on the forecasted first quarter 2011 financial results of the ICS Business.

On November 8, 2010, representatives of NeXtAdvisors had a conference call with Party C to discuss the additional contingent consideration based on the forecasted first quarter 2011 financial results of the ICS Business. Party C expressed a willingness to include additional contingent consideration, but stated that it was still determining the appropriate multiple to apply to the forecasted first quarter 2011 financial results of the ICS Business.

Also on November 8, 2010, representatives of NeXtAdvisors had a conference call with TeleTech, who indicated that its final offer was \$43 million. In addition, subject to review by its counsel, TeleTech requested that 5% of the purchase price be held in escrow to ensure compliance with the Company's representations and warranties set forth in any definitive agreement.

On November 10, 2010, our senior management and NeXtAdvisors sent Party B, Party C, and TeleTech updated financial information relating to the ICS Business, including actual third quarter 2010 financial results and forecasted results for the fourth quarter of 2010 and the first quarter of 2011.

On November 11, 2010, Party B submitted a revised non-binding indication of interest relating to the sale of the ICS Business, which proposed a bid range of \$40 million to \$45 million and expressed a willingness to increase the bid with additional contingent consideration.

On November 13, 2010, representatives of NeXtAdvisors and senior management had a conference call with Party C to discuss the material terms of Party C's Initial Indication and clarify certain positions and calculations. Specifically, the parties addressed their respective definitions of the managed services amount and working capital adjustment and their opinions regarding the appropriate levels of each at the time of sale. Senior management determined that Party C was calculating the managed services amount and working capital adjustment in a different manner than Party B and TeleTech, which would result in eLoyalty receiving less cash at closing based on the latest available balance sheet of the ICS Business. Representatives of NeXtAdvisors, senior management, and Party C also discussed Party C's requirements regarding capital expenditures, desired escrow amounts, and the ICS Business' actual third quarter 2010 financial results and revised forecasted financial results for the fourth quarter of 2010 and the first quarter of 2011.

On November 15, 2010, Party C sent an email to NeXtAdvisors as a follow up to the conversation that took place on November 13, 2010. Party C indicated in its email a willingness to increase the proposed additional contingent consideration based on operating performance of the ICS Business in the first quarter of 2011. Party C proposed a risk sharing approach whereby the increase or decrease in trailing twelve-month EBITDA for the ICS Business at the end of the first quarter of 2011 would be divided in 60% and 40% proportions between eLoyalty and Party C, respectively. Party C also proposed a reduction in its original bid from \$40.5 million to \$39.6 million. The reduction in Party C's bid was based on the application of the implied multiple contained in their Initial Indication to the revised forecasted financial results of the ICS Business for the fourth quarter of 2010.

Party C also indicated in the email dated November 15, 2010 that it would reduce the escrow period from 24 months to 18 months, but would like to increase the amount to be held in escrow based on the same implied percentage in its Initial Indication, assuming the additional contingent consideration were paid out. Party C indicated a willingness to amend its capital expenditure requirements, subject to further diligence. Finally, Party C confirmed the manner in which it proposed purchase price adjustments based on the managed services amounts and working capital, which remained different from the calculations prepared by senior management and the other bidders.

On November 15, 2010, TeleTech submitted a revised non-binding indication of interest relating to the sale of the ICS Business, which, as discussed during the November 8, 2010 conference call, increased its original bid from \$42 million to \$43 million.

On November 17, 2010, our senior management had a meeting with Party B in an effort to determine the seriousness of Party B's bid and assess its progress on securing financing. Our senior management discussed potential areas of synergies in an effort to assist Party B with its financial model to finalize their bid.

On November 21, 2010, representatives of NeXtAdvisors had a conference call with Party B's bankers to discuss the bid range. The bankers tightened the bid range to \$42 million to \$45 million. The parties also discussed Party B's ability to finance the transaction, as its Initial Indication included a financing contingency. Party B's bank indicated it was currently in discussion with several other banks and private equity firms. They asked that Party B's potential financing sources be granted access to the electronic data room, as well as be supplied with additional information regarding the ICS Business' first quarter 2011 forecasted financial results. Data room access and the requested financial information were provided to two of Party B's potential financing sources.

On December 1, 2010, representatives of NeXtAdvisors and our senior management had a conference call with Party B during which Party B indicated that its final bid was \$40 million and it would not be offering any additional contingent consideration based on first quarter 2011 financial results of the ICS Business. Our senior management informed Party B that it did not expect to continue negotiations with Party B due to the lower purchase price and remaining financing uncertainties.

On December 7, 2010, our senior management and representatives of NeXtAdvisors held a telephonic meeting with our board to update them as to the status of the efforts undertaken to date in connection with the proposed sale of the ICS Business, as well as a summary of the key points requiring negotiation with the remaining bidders, Party C and TeleTech. Based on an analysis of the terms proposed, our board of directors authorized senior management to execute an exclusivity agreement with TeleTech. However, Party C's bid continued to include unresolved working capital and escrow issues that, if resolved favorably for the Company, could result in Party C's bid being more favorable than TeleTech's. As a result, our board directed senior management and NeXtAdvisors to continue discussions with both bidders regarding working capital and escrow issues in their respective bids prior to executing an exclusivity agreement.

On December 8, 2010, representatives of NeXtAdvisors and senior management had a conference call with TeleTech to discuss the definition of working capital and working capital requirements at closing. During the course of the conference call, the parties reached an agreement on the definition of working capital and the appropriate ratio for making a working capital adjustment to the purchase price.

The following day, TeleTech submitted a further revised non-binding indication of interest relating to the sale of the ICS Business (the TeleTech Second Revised Indication). The TeleTech Second Revised Indication updated certain material terms, including the adjustment to the purchase price based on a working capital ratio, and the terms of the escrow, which was set at 5% of the purchase price to be held for a period of six months.

Over the next few days, representatives of NeXtAdvisors and senior management conducted a series of follow-up conference calls with TeleTech and Party C to further refine certain terms, including the adjustment to the purchase price based on the working capital ratio.

During a follow-up conference call with Party C on December 10, 2010, Party C confirmed that the proposed terms set forth in its email dated November 15, 2010 were final. Our senior management notified Party C that, as a result, it would not be pursuing further negotiations with Party C. Senior management also updated our board of directors on the results of its discussions over the preceding three days with TeleTech and Party C.

Also on December 10, 2010, TeleTech submitted a further revised non-binding indication of interest relating to the sale of the ICS Business (the TeleTech Third Revised Indication ). The TeleTech Third Revised Indication reflected agreements made during conference calls between representatives of Winston & Strawn and Neal, Gerber & Eisenberg LLP, outside counsel to TeleTech ( Neal Gerber ).

On December 13, 2010, eLoyalty executed TeleTech's Third Revised Indication (the Executed Indication ), which included an exclusivity agreement pursuant to which eLoyalty agreed to only negotiate with TeleTech regarding the sale of the ICS Business for a period of sixty days. On December 13, 2010, TeleTech and its representatives were granted full access to the electronic data room that contained additional materials and documents relating to the ICS Business.

On December 20, 2010, our board of directors held a special telephonic meeting and determined to designate a special committee in connection with the sale of the ICS Business (the Special Committee ). Our board determined to designate a special committee because the Series B Stock is entitled to certain rights and preferences upon the sale of the ICS Business, and certain members of the board are holders of Series B Stock or may be deemed affiliates of holders of Series B Stock. The members of the Special Committee, Messrs. Mullen, Kohler, and Staley, are disinterested directors who do not, directly or indirectly, hold any shares of Series B Stock. The Special Committee was designated for the purpose of reviewing and evaluating potential uses of proceeds from the sale of the ICS Business, including potential distributions to stockholders, and making a recommendation to the full board regarding such use of proceeds. The Special Committee held its first meeting on December 23, 2010.

On January 5, 2011, TeleTech delivered to eLoyalty a first draft of the Acquisition Agreement based on the Executed Indication. As TeleTech conducted its due diligence, Winston & Strawn and Neal Gerber began negotiations on the terms of the Acquisition Agreement. On January 13, 2011, our senior management, TeleTech, NeXtAdvisors, Winston & Strawn, and Neal Gerber held a meeting at the offices of Winston & Strawn to discuss TeleTech's initial draft of the Acquisition Agreement. Negotiations over the terms of the Acquisition Agreement focused primarily on the details of the purchase price adjustments, termination fees and expenses, the escrow amount, the scope of the representations and warranties, the indemnification cap, and the indemnification deductible, and continued for the next several weeks, with the parties exchanging multiple drafts of an Acquisition Agreement.

On January 20, 2011, the Special Committee held a meeting in order to analyze the expected net proceeds from the sale of the ICS Business under various assumptions provided by management. The Special Committee also reviewed the Behavioral Analytics Service Business Unit cash flow forecast, sales plan, development plan, and other projections provided by management.

On February 11, 2011, TeleTech informed senior management and NeXtAdvisors that TeleTech's financial due diligence suggested higher projected general and administrative expenses for the ICS Business than those previously estimated. As a result, TeleTech believed that a reduction in the purchase price was warranted. NeXtAdvisors met with TeleTech on February 14, 2011 to discuss a purchase price reduction of approximately \$2.15 million. The following day, our senior management, TeleTech, NeXtAdvisors, Winston & Strawn, and Neal Gerber met to continue negotiations over the proposed purchase price reduction and its interplay with the

other open terms of the Acquisition Agreement, including the details of the purchase price adjustments, termination fees and expenses, the escrow amount, the indemnification cap, and the indemnification deductible.

The exclusivity period in the Executed Indication ended on February 11, 2011. As a result, senior management directed NeXtAdvisors to contact bidders that had expressed interest in the ICS Business in order to inform them of the developments with TeleTech and gauge their interest in renewing negotiations. NeXtAdvisors focused in particular on Party C and Party D. NeXtAdvisors provided certain updated financial information for the ICS Business to Party C and Party D and discussed with each of them over the next four days whether their prior bids could be increased. Party D did not express any interest in increasing its original bid range of \$31 to \$38 million.

On February 16, 2011, NeXtAdvisors and senior management updated our board of directors of the recent developments with TeleTech and discussed the benefits and effects of continuing negotiations with TeleTech or proceeding with discussions with other potential buyers. Our board of directors determined to pursue parallel paths of continuing negotiations TeleTech under the proposed purchase price reduction while continuing to try to make progress with Party C. NeXtAdvisors and senior management continued to discuss terms with Party C following the meeting on February 16, 2011. It was ultimately determined that there was little ability to achieve or confirm a higher bid from Party C than TeleTech's revised bid. Party C's proposal also continued to include escrow and working capital requirements that were significantly less favorable to the Company than TeleTech's proposed terms.

Effective February 18, 2011, the Company and TeleTech executed an amendment to the Executed Indication, which reflected a revised purchase price of \$40.85 million, extended of the exclusivity period until February 28, 2011, and contained various other terms negotiated at the February 15, 2011 meeting. On February 23, 2011, Neal Gerber delivered a revised draft of the Acquisition Agreement in order to reflect the recent negotiations.

Between February 14, 2011 and February 25, 2011, the Special Committee held four additional meetings in order to review and assess whether a distribution of net proceeds from the sale of the ICS Business was appropriate and in the best interests of the Company and its stockholders. Also during this time, the Special Committee engaged in discussions with our two largest holders of Series B Stock, TCV and Sutter Hill Ventures (SHV), in order to discuss the proposed transaction in light of the provisions of the Series B Designations. See *SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT Series B Stock Ownership Information*.

On February 28, 2011, our board of directors conducted a special meeting for the purpose of reviewing the terms of the proposed Acquisition Agreement. Also in attendance were representatives of NeXtAdvisors and Winston & Strawn. At this meeting, representatives of Winston & Strawn reviewed the material terms of the Acquisition Agreement and ancillary agreements, the current drafts of which had been previously circulated to and reviewed by all of the directors. Representatives of NeXtAdvisors reviewed with the board NeXtAdvisors' financial analyses of the proposed transaction and indicated that, under the current terms, NeXtAdvisors would be in a position to issue a fairness opinion.

At the meeting on February 28, 2011, the Special Committee also provided its current recommendation to the board that, based on an analysis of expected net proceeds under various assumptions and a review of projections for the Behavioral Analytics Service Business Unit, an immediate distribution to stockholders of net proceeds from the sale of the ICS Business would not be advisable and in the best interests of the Company. The Special Committee also updated the board on its discussions with TCV and SHV. SHV appeared willing to execute a voting agreement as requested by TeleTech. On the other hand, TCV indicated that it would not execute a voting agreement unless an agreement or resolution was reached on the timing and manner of cash distributions to be made to the holders of Series B Stock following the sale of the ICS Business.

TeleTech required voting agreements representing approximately 50% of the outstanding voting power to be executed in connection with the Acquisition Agreement. Between March 2, 2011 and March 10, 2011, the Company entered into confidentiality agreements with certain significant stockholders, and senior management discussed the proposed sale of the ICS Business with such stockholders. These stockholders, together with the Company's directors and executive officers, agreed to execute voting agreements binding them to vote in favor of the sale of the ICS Business at the Annual Meeting.

Between March 1, 2011 and March 10, 2011, the Company's senior management, TeleTech, Neal Gerber, and Winston & Strawn continued to work toward finalizing the Acquisition Agreement. The parties primarily discussed disclosure schedules, working capital mechanics, and issues regarding transferred employees and accounting systems. Neal Gerber delivered a revised draft of the Acquisition Agreement on March 11, 2011.

On March 11, 2011, our board of directors conducted a special meeting for the purpose of updating its prior discussion on the proposed Acquisition Agreement. Also in attendance were representatives of NeXtAdvisors, Winston & Strawn, and Potter Anderson & Corroon LLP, special Delaware counsel for the Company (Potter Anderson). At this meeting, representatives of NeXtAdvisors reviewed with the board NeXtAdvisors' financial analyses of the proposed transaction and presented the board with its oral opinion that the consideration to be received by eLoyalty was fair, from a financial point of view, to eLoyalty. Representatives of Winston & Strawn reviewed and discussed the directors' fiduciary duties in approving the sale transaction and provided an update on the principal terms of the Acquisition Agreement. Winston & Strawn also discussed with the board certain factors in favor of the sale of the ICS Business, as well as certain risks and potentially negative factors.

Representatives of Winston & Strawn and Potter Anderson discussed with our board of directors the impact that a sale of the ICS Business would have on the rights of the holders of Series B Stock, including the position expressed by TCV, both directly and through its outside legal counsel, that a cash payment equal to the amount of the liquidation preference is due to the holders of Series B Stock immediately upon the closing of the proposed sale. Counsel advised our board that the Series B Designations do not specify the time period or manner in which the liquidation preference is to be paid to the holders of Series B Stock following the sale of the ICS Business. Counsel also advised that, prior to any distribution being made, the Series B Designations should be amended to clarify, among other things, whether a partial payment would reduce the liquidation preference and to specify the effect of a full payment of the liquidation preference on the future dividend and priority rights of the Series B Stock. Further, counsel discussed with the board that a payment of all or any portion of the liquidation preference requires a determination that the Company has funds available for distribution under state law and that a distribution is in the best interests of the Company's stockholders as a whole.

After deliberating, our board of directors determined that the Acquisition Agreement and the transactions contemplated thereby were advisable, fair to, and in the best interests of eLoyalty stockholders, and voted unanimously (with one abstention) to approve them. Our board also voted unanimously (with one abstention) to designate the Special Committee as a standing committee of the board for the purposes of, among other things, assessing from time to time whether eLoyalty has available funds for a full or partial distribution of the liquidation preference to the holders of Series B Stock and continuing to engage in related discussions and negotiations with the holders of Series B Stock. Mr. Feinberg abstained from voting on both items after noting the lack of resolution with the holders of Series B Stock with respect to the payment of the liquidation preference. Later that day, NeXtAdvisors delivered the written fairness opinion attached hereto as *Annex C*.

Following the March 11, 2011 board meeting, Winston & Strawn, on behalf of eLoyalty, conducted telephonic discussions and negotiations with Neal Gerber, on behalf of TeleTech, in order to finalize the Acquisition Agreement and the related ancillary agreements. Between March 12, 2011 and March 17, 2011, TeleTech worked with certain employees of the ICS Business to finalize the terms of employment agreements with TeleTech, which will become effective upon the closing of the sale of the ICS Business.

On March 17, 2011, eLoyalty and TeleTech executed the Acquisition Agreement and ancillary agreements. On March 17, 2011, eLoyalty issued a press release announcing the sale of the ICS Business to TeleTech.

### Reasons for the Sale of the ICS Business

Our board of directors recommends approving the sale of the ICS Business because we believe that separating the ICS Business from our Behavioral Analytics Service Business Unit will enhance our potential to maximize value for our stockholders. We believe that focusing on our Behavioral Analytics Service Business Unit will permit greater management focus on what we believe to be our greatest opportunity for growth and long-term stockholder value. Operating the businesses separately will better position each business to realize its full potential without any restrictions from the other.

In evaluating the Acquisition Agreement and the other transactions contemplated thereby, including the sale of the ICS Business, and recommending that our stockholders approve the sale of the ICS Business and approve the Acquisition Agreement in accordance with the applicable provisions of Delaware law, our board of directors consulted with our senior management, outside legal counsel, and financial advisors. Our board of directors also consulted with outside legal counsel regarding the board's fiduciary duties, legal due diligence matters, and the terms of the Acquisition Agreement and related agreements. Based on these consultations, and the factors and the opinion of NeXtAdvisors discussed below and, in the case of the opinion, attached as *Annex C*, our board of directors concluded that the sale of the ICS Business was in the best interests of our stockholders and recommended that our stockholders adopt the Acquisition Agreement and approve the sale of the ICS Business.

The factors that our board of directors considered in reaching its determination included, but were not limited to, the following:

the amount of cash consideration to be received by us pursuant to the Acquisition Agreement;

financial information concerning the ICS Business and our Behavioral Analytics Service Business Unit, as well as current industry, economic, and market conditions relating to the ICS Business and our Behavioral Analytics Service Business Unit;

the possibility that the short- and long-term prospects of the ICS Business would continue to decline while the Behavioral Analytics Service Business Unit would continue to grow;

the need for long-term capital investment in both the ICS Business and our Behavioral Analytics Service Business Unit;

the facts that the ICS Business and our Behavioral Analytics Service Business Unit are two distinct segments without significant operating synergies and that the continued operation of the two businesses together may hinder their respective short- and long-term growth prospects;

the possibility that the Behavioral Analytics Service Business Unit's current and prospective customers, employees, and business partners may prefer to work with us as a pure play technology solution company;

our belief that we could create a more focused brand, business model, and investment opportunity with our Behavioral Analytics Service Business Unit as a stand-alone business;

the increased focus our management could place on our growing Behavioral Analytics Service Business Unit following the sale of the ICS Business;

the fact that the ICS Business is almost entirely dependent on its relationship with Cisco Systems, Inc. and has demonstrated an overreliance on consulting services;

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the extensive process we conducted with respect to the sale of the ICS Business, which covered a period of more than nine months and involved discussions with multiple parties to determine their interest in purchasing the ICS Business, none of which led to acquisition proposals that were as favorable to us as TeleTech's proposal;

the financial projections for the ICS Business set forth under *Projected Financial Information* on page 28;

the financial presentation of our financial advisor, NeXtAdvisors, including its oral opinion delivered to our board of directors on March 11, 2011, and subsequently confirmed in writing on March 11, 2011 (the full text of which is attached as *Annex C* to this proxy statement) as to the fairness, from a financial point of view and as of the date of the opinion, to us of the consideration to be received by us in the sale of the ICS Business, as more fully described below under the caption "The Sale of the ICS Business" Opinion of NeXtAdvisors ;

the business reputation, management, and financial resources of TeleTech, which our board of directors believed supported the conclusion that a transaction with TeleTech could be completed relatively quickly and efficiently;

the fact that the sale of the ICS Business would enable us to benefit from our existing net operating loss carryforward;

the fact that the Acquisition Agreement affords our board of directors flexibility to consider, evaluate, and accept superior proposals and alternative transactions in the period after signing and prior to the approval of the sale of the ICS Business by our stockholders under certain circumstances set forth in the Acquisition Agreement;

the reasonable likelihood of the consummation of the sale of the ICS Business in light of the relatively limited conditions to TeleTech's obligations to consummate the sale of the ICS Business, including the fact that the consummation of the sale of the ICS Business is not contingent on TeleTech's ability to secure financing commitments; and

the alternatives available if we were not to sell the ICS Business to TeleTech, including independent pursuit of growth of the ICS Business, all of which involve meaningful risks and uncertainties and none of which, in the view of our board of directors, were as favorable to us and our stockholders as, nor more favorable to us and our stockholders than, the sale of the ICS Business.

Our board of directors also identified and considered a number of uncertainties, risks, and potentially negative factors in its deliberations concerning the sale of the ICS Business, including:

the possibility that the transactions contemplated by the Acquisition Agreement, including the sale of the ICS Business, might not be consummated, and the facts that if the sale of the ICS Business is not consummated, (i) our directors, executive officers, and other employees will have expended extensive time and effort and will have experienced significant distractions from their work during the pendency of the transaction, (ii) we will have incurred significant transaction costs, and (iii) the potential negative market perception of our continuing business could potentially result in a loss of customers, business partners, and employees, any of which may have a material and adverse effect on our stock price and results of operations;

the effect of the public announcement of the sale of the ICS Business and the Acquisition Agreement, including effects on our sales and customer relationships, operating results, stock price, and our ability to attract and retain key management and sales and marketing personnel;

the resultant loss of revenue and gross profit from the ICS Business and the fact that our stockholders will not participate in any future profit or growth of the ICS Business;

the fact that, after the sale of the ICS Business, we will be entirely dependent on the performance of our Behavioral Analytics Service Business Unit, which has not been profitable to date;

the fact that the sale of the ICS Business is considered a liquidation under the terms of the Series B Designations and, as a result, would give rise to certain rights and preferences to the holders of Series B Stock;



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the restrictions on the conduct of the ICS Business prior to completion of the sale of the ICS Business, requiring us to conduct the ICS Business only in the ordinary course, subject to specific limitations or TeleTech's consent, which may delay or prevent us from undertaking business opportunities that may arise pending completion of the sale of the ICS Business;

the restrictions on the Company's ability to solicit or engage in discussions or negotiations with a third party regarding alternative transactions, and the requirement that we pay TeleTech a termination fee and/or termination expenses in certain cases in the event of a termination of the Acquisition Agreement;

the risk we will not be able to satisfy some or all of the conditions to TeleTech's obligations to consummate the sale of the ICS Business;

the risk that we could be exposed to future indemnification payments for a breach or violation of the representations and warranties or covenants contained in the Acquisition Agreement;

the risk that unforeseen liabilities and expenses may be incurred that may limit the ultimate amount of net proceeds from the sale of the ICS Business;

the significant costs involved in consummating the sale of the ICS Business, including financial advisory fees, legal, accounting, and other costs, which we estimate to be approximately \$2.0 million; and

the interests that our executive officers and directors may have with respect to the sale of the ICS Business in addition to their interests as stockholders of our company.

After careful and due consideration, our board of directors concluded that overall, the risks, uncertainties, restrictions, and potentially negative factors associated with the sale of the ICS Business were outweighed by the potential benefits of the sale of the ICS Business, and that many of these risks could be managed or mitigated prior to the consummation of the sale of the ICS Business or were unlikely to have a material adverse effect on our Company.

The foregoing information and factors considered by our board of directors are not intended to be exhaustive but are believed to include all of the material factors considered by our board of directors. In view of the variety of factors and the amount of information considered, our board of directors did not find it practicable to, and did not, quantify, rank or otherwise assign relative weights to the specific factors it considered in approving the sale of the ICS Business and the Acquisition Agreement. In addition, individual members of our board of directors may have given different weights to different factors. Our board of directors considered all of these factors as a whole, and overall considered them to be favorable to and to support its determination.

### **Projected Financial Information**

eLoyalty does not as a matter of course make public projections as to future performance or earnings due to the unpredictability of the underlying assumptions and estimates. However, certain non-public prospective financial information about the ICS Business was prepared by our senior management and made available to NeXtAdvisors, our board of directors, TeleTech, and other third-party bidders in connection with their consideration and evaluation of the proposed transaction.

We have included the material portion of the projections regarding the ICS Business in the table below to give our stockholders access to certain non-public information considered by NeXtAdvisors, our board of directors and TeleTech for purposes of considering and evaluating the proposed sale of the ICS Business. We have included in this proxy statement projections for the 2011 fiscal year, which were made available to NeXtAdvisors in February 2011 for purposes of preparing its financial analyses. Sets of projections for the fourth quarter of 2010 and the first quarter of 2011 were made available to NeXtAdvisors, TeleTech, and other third-party bidders during our negotiations for the sale of the ICS Business, but we do not believe that such projections are material for purposes of this proxy statement due to the fact that actual results for such periods are currently available or will be available prior to the date of the Annual Meeting.

As of the date of this proxy statement, we were not aware of anything that would materially change our projections for the 2011 fiscal year, but actual results might differ materially. The inclusion of this forecast

should not be regarded as an indication that NeXtAdvisors, our board of directors, TeleTech, or any other recipient of the information considered, or now considers, it to be a reliable prediction of future results. You should not place undue reliance on the projected financial information set forth below. No one has made or makes any representation to any stockholder regarding this projected financial information.

	<b>Fiscal Year 2011 Forecast for the ICS Business</b> (in thousands)
Revenue	\$ 61,625
Direct Costs	43,263
<b>Gross Margin</b>	<b>18,362</b>
Sales & Marketing	5,713
G&A Expenses	1,627
Total Operating Costs	7,340
Operating Margin	\$ 11,022
Corporate G&A Expenses <sup>(1)</sup>	1,550
<b>EBITDA</b>	<b>\$ 9,472</b>

- (1) Estimate of certain eLoyalty company-wide G&A expenses attributable to the ICS Business, including expenses related to staffing, facilities, insurance, accounting systems, and tax support.

We have advised recipients of our projected financial information that the information upon which it was based is subjective in many respects. The projected financial information reflects numerous assumptions with respect to industry performance, general business, economic, market, and financial conditions, and other matters, all of which are difficult to predict and beyond our control. The projected financial information also reflects estimates and assumptions related to our business that are inherently subject to significant economic and competitive uncertainties, all of which are difficult to predict and many of which are beyond our control. In addition, we believe that projecting financial performance for the ICS Business is inherently difficult due to the nature of its revenue, particularly in the product resale portion of the ICS Business. As a result, the projected results might not be realized and actual results might be significantly better or worse than projected. The projected financial information was not prepared with a view toward public disclosure or toward complying with generally accepted accounting principles, or GAAP, the published guidelines of the SEC regarding projections or the guidelines established by the American Institute of Certified Public Accountants for preparation and presentation of prospective financial information. The projected financial information included herein has been prepared by, and is the responsibility of, our management, and none of TeleTech, our board of directors, or NeXtAdvisors was involved in the preparation of the projected financial information or has any responsibility for the projected financial information.

The projected financial information has been prepared on a basis substantially consistent with the accounting principles used in our historical financial statements. For the foregoing reasons, as well as the basis and assumptions on which the projected financial information was compiled, the inclusion of the projected financial information in this proxy statement should not be regarded as an indication that such projected financial information will be an accurate prediction of future events, and this information should not be relied on as such. Except as required by applicable securities laws, eLoyalty does not intend to update or otherwise revise the projected financial information to reflect circumstances existing after the date when made or to reflect the occurrence of future events, even in the event that any or all of the assumptions are shown to be incorrect.

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**Opinion of NeXtAdvisors**

***Opinion***

On March 11, 2011, at a meeting of our board of directors held to evaluate the transaction, NeXtAdvisors, a unit of North Point Advisors LLC, a member of FINRA<sup>1</sup>, our financial advisor, delivered to our board an oral opinion, confirmed by delivery of a written opinion, dated March 11, 2011, to the effect that, based upon and subject to the limitations and qualifications set forth in the opinion, as of the date of the opinion, the consideration to be received by eLoyalty in the sale of the ICS Business is fair from a financial point of view to eLoyalty.

The full text of the NeXtAdvisors opinion describes the assumptions made, procedures followed, matters considered and limitations on the review undertaken by NeXtAdvisors. This opinion is attached as *Annex C* to this proxy statement and is incorporated into this proxy statement by reference. **We encourage our stockholders to read this opinion carefully in its entirety.**

The opinion (i) does not address the merits of the underlying business decision to enter into the proposed transaction versus any alternative strategy or transaction; (ii) does not address any transaction related to the proposed transaction; (iii) is not a recommendation as to how our board of directors or any stockholder should vote or act with respect to any matters relating to the proposed transaction, or whether to proceed with the proposed transaction or any related transaction; and (iv) does not indicate that the consideration received is the best possibly attainable under any circumstances. Instead, the opinion merely states whether the consideration in the proposed transaction is within a range suggested by certain financial analyses discussed with and approved in advance by eLoyalty, which analyses did not include the Excluded Analyses (as defined below), among others. The decision as to whether to proceed with the proposed transaction or any related transaction may depend on an assessment of factors unrelated to the financial analyses on which the opinion is based. In rendering the opinion, NeXtAdvisors expressed no opinion with respect to the amount or nature of any compensation to any of our officers, directors, or employees, or any class of such persons, relative to the consideration to be received by eLoyalty in the proposed transaction, or with respect to the fairness of any such compensation. The opinion should not be construed as creating any fiduciary duty on the part of NeXtAdvisors to any party.

In connection with the opinion, NeXtAdvisors made such reviews, analyses, and inquiries as it deemed necessary and appropriate under the circumstances. NeXtAdvisors also took into account its assessment of general economic, market, and financial conditions, as well as its experience in securities and business valuation, in general, and with respect to similar transactions, in particular. NeXtAdvisors' procedures, investigations, and financial analysis with respect to the preparation of its opinion included, but were not limited to, the items summarized below.

NeXtAdvisors, among other things:

Reviewed certain internal financial information and other data relating to the ICS Business and its financial prospects that were provided to NeXtAdvisors by the management of eLoyalty, including financial forecasts and estimates prepared by the management of eLoyalty;

Discussed certain short and long-term challenges that management of eLoyalty believes confront eLoyalty if eLoyalty were to retain the ICS Business, including without limitation the question of customer concentration;

Reviewed information obtained during discussions with members of the management and our board of directors concerning certain aspects of the proposed transaction and the business and financial prospects of the ICS Business;

<sup>1</sup> North Point Advisors, LLC is a securities broker/dealer registered with FINRA and the Securities and Exchange Commission and has registered offices in California and Illinois. North Point conducts business out of its Illinois office under the name NeXtAdvisors.

Performed certain valuation and comparative analyses using generally accepted valuation and analytical techniques including a discounted cash flow analysis, an analysis of selected public companies that NeXtAdvisors deemed relevant, and an analysis of selected transactions that NeXtAdvisors deemed relevant;

Compared the financial terms of the proposed transaction with publicly-available financial terms of certain other transactions that NeXtAdvisors believed to be generally relevant;

Reviewed a draft of the Acquisition Agreement dated March 10, 2011;

Discussed the information referred to above and the background and other elements of the proposed transaction with the management of eLoyalty; and

Conducted such other analyses and considered such other factors as NeXtAdvisors deemed appropriate.

In performing its analyses and rendering the opinion with respect to the proposed transaction, NeXtAdvisors, with our consent:

Relied upon the accuracy, completeness, and fair presentation of all information, data, advice, opinions, and representations obtained from public sources or provided to it from private sources, including our management, and did not independently verify such information;

Relied upon the fact that our board of directors and the Company have been advised by counsel as to all legal matters with respect to the proposed transaction, including whether all procedures required by law to be taken in connection with the proposed transaction have been duly, validly, and timely taken;

Assumed that any estimates, evaluations, forecasts, and projections furnished to NeXtAdvisors were reasonably prepared and based upon the best currently available information and good faith judgment of the person furnishing the same;

Assumed that information supplied and representations made by our management are substantially accurate regarding the Company and the proposed transaction;

Assumed that the representations and warranties made in the Acquisition Agreement are substantially accurate;

Assumed that the final versions of all documents reviewed by NeXtAdvisors in draft form conform in all material respects to the drafts reviewed;

Assumed that there has been no material change in the assets, financial condition, business, or prospects of the ICS Business since the date of the most recent financial statements and other information made available to NeXtAdvisors;

Assumed that all of the conditions required to implement the proposed transaction will be satisfied and that the proposed transaction will be completed in accordance with the Acquisition Agreement without any amendments thereto or any waivers of any material terms or conditions thereof; and

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Assumed that all governmental, regulatory or other consents and approvals necessary for the consummation of the proposed transaction will be obtained without any adverse effect on eLoyalty.

To the extent that any of the foregoing assumptions or any of the facts on which the opinion is based prove to be untrue in any material respect, the opinion cannot and should not be relied upon. Furthermore, in NeXtAdvisors' analysis and in connection with the preparation of the opinion, NeXtAdvisors has made numerous assumptions with respect to industry performance, general business, market and economic conditions and other matters, many of which are beyond the control of any party involved in the proposed transaction.

NeXtAdvisors prepared the opinion effective as of its date. This opinion is necessarily based upon market, economic, financial and other conditions as they existed and could be evaluated as of that date, and NeXtAdvisors disclaims any undertaking or obligation to advise any person of any change in any fact or matter affecting the opinion which may come or be brought to the attention of NeXtAdvisors after the date of the opinion.

NeXtAdvisors did not evaluate our solvency or conduct an independent appraisal or physical inspection of any specific assets or liabilities (contingent or otherwise), nor was NeXtAdvisors furnished with any such evaluations or appraisals.

NeXtAdvisors did not express any opinion as to the market price or value of the Common Stock after announcement of the proposed transaction. The opinion should not be construed as a valuation opinion, a credit rating, a solvency opinion, or an analysis of our credit worthiness, and does not address the legal, tax or accounting consequences of the proposed transaction on eLoyalty or the holders of its securities. NeXtAdvisors has not made, and assumes no responsibility to make, any representation, or render any opinion, as to any legal matter.

Furthermore, NeXtAdvisors, with eLoyalty's consent, (i) did not review or perform any analyses with respect to any business of eLoyalty other than the ICS Business, and (ii) did not review or perform any analyses relating to the historical trading prices of the Common Stock, including without limitation any comparison of the consideration to be received by eLoyalty in the proposed transaction, on the one hand, to such historical trading prices and the value of our other businesses, on the other (the excluded analyses described in clauses (i) and (ii) are referred to together herein as the "Excluded Analyses").

The opinion was furnished for the use and benefit of our board of directors in connection with its evaluation of the transaction. In addition, our board of directors has not asked NeXtAdvisors to address, and its opinion did not address, the fairness to, or any other consideration of, the holders of any class of securities, creditors or other constituencies of eLoyalty. The opinion has been approved by the Opinion Review Committee of NeXtAdvisors.

#### *Financial Analyses*

The following is a summary of the material analyses that NeXtAdvisors prepared in connection with its opinion. This summary includes information presented in tabular format. In order to understand fully the financial analyses used by NeXtAdvisors, these tables must be read together with the text of each summary. The tables alone do not constitute a complete description of the financial analyses.

In performing its financial analyses, NeXtAdvisors noted the following:

The ICS Business, including its revenue and EBITDA, is almost entirely dependent on its relationship with Cisco Systems, Inc.;

Client losses occurred in the first and second quarters of 2010; and

The ICS Business' EBITDA is dependent on an estimated Corporate G&A expense allocation of \$1.5 million in 2010, calculated by management. Financial forecasts incorporate this estimate, with a 3% per year inflation assumption beginning in 2011.

NeXtAdvisors did not separately assess the validity of this allocation.

The summary set forth below does not purport to be a complete description of the analyses performed by NeXtAdvisors in arriving at its opinion. The fact that any specific analysis has been referred to in the summary below or in this proxy statement is not meant to indicate that such analysis was given more weight than any other analysis. The preparation of a fairness opinion is a complex process involving various determinations as to the most appropriate and relevant methods of financial analysis and the application of those methods to the particular circumstances; therefore, such an opinion is not readily susceptible to partial analysis or summary description. No company, business or transaction used in such analyses as a comparison is identical to the ICS Business or the proposed sale of the ICS Business, nor is an evaluation of such analyses entirely mathematical. In arriving at its opinion, NeXtAdvisors did not attribute any particular weight to any analysis or factor considered by it, but rather made qualitative judgments as to the significance and relevance of each analysis and factor. Accordingly, NeXtAdvisors believes that its analyses must be considered as a whole and that selecting portions of its analyses and of the factors considered by it, without considering all factors and analyses, would, in the view of NeXtAdvisors, create an incomplete and misleading view of the analyses underlying NeXtAdvisors' opinion.

*Selected Comparable Public Company Analysis*

Based on public and other available information, NeXtAdvisors calculated the multiples of enterprise value (EV) to 2010 calendar year EBITDA for selected communication services companies. As the ICS Business 2010 calendar year EBITDA also represents its last twelve months (LTM) EBITDA, NeXtAdvisors considered the corresponding period for the selected companies. For the purposes of its analysis, NeXtAdvisors defined enterprise value as equity value plus any debt, preferred stock, and minority interest less cash and cash equivalents; NeXtAdvisors defined EBITDA as earnings before interest, taxes, depreciation and amortization adjusted for one-time expenses and non-cash charges including stock-based compensation expense. Companies were selected, among other reasons, because they share similar business characteristics with the ICS Business based on operational characteristics and financial metrics. However, none of the companies selected is identical or directly comparable to the ICS Business. The 2010 revenue of each of the selected companies exceeds that of the ICS Business, and none of the selected companies is almost entirely dependent on any single vendor or provider as is the case for the ICS Business. Accordingly, NeXtAdvisors made judgments and assumptions concerning differences in financial and operating characteristics of the selected companies and other factors that could affect the public trading value of the selected companies. The companies selected include:

Black Box Corporation

Cbeyond, Inc.

Hickory Tech Corporation

The following table sets forth the multiples indicated by this analysis, as compared to the purchase price multiple of 5.7x 2010 EBITDA:

	Range of All Companies		First Quartile	Third Quartile
EV / 2010A EBITDA	5.2x	6.9x	5.3x	6.2x

*Selected M&A Transactions Analysis*

NeXtAdvisors selected the three transactions listed below based on having a similar operational characteristics and financial metrics to the ICS Business as well as having publicly available information. Using this information, NeXtAdvisors calculated the multiples of enterprise value to LTM EBITDA. Given the lack of recent comparably sized transactions with public information, NeXtAdvisors included the \$3.2 billion sale of Dimension Data Holdings plc to Nippon Telegraph & Telephone Corporation. Due to the size and global diversity of the Dimension Data business (\$4.2 billion in LTM revenue at time of the acquisition), NeXtAdvisors applied a 50% discount to the multiple paid by Nippon Telegraph & Telephone Corporation. It should also be noted that at the time of the Enventis Telecom acquisition, Black Box Corporation, Cbeyond, Inc. and Hickory Tech Corporation were trading at a median of 12.1x LTM EBITDA. At the time of the Berbee Information Networks Corporation acquisition, the group was trading at a median of 9.8x LTM EBITDA. As of market close on March 10, 2011, the day before NeXtAdvisors issued its opinion, this group was trading at 5.5x LTM EBITDA.

Date Announced	Target	Acquirer
7/15/10	Dimension Data Holdings plc	Nippon Telegraph & Telephone Corporation
9/18/06	Berbee Information Networks Corporation	CDW Corporation
11/9/05	Enventis Telecom	Hickory Tech Corporation



The following table sets forth the multiples indicated by this analysis, as compared to the purchase price multiple of 5.7x 2010 (LTM) EBITDA:

	Range of All Companies		First Quartile	Third Quartile
EV / LTM EBITDA*	4.8x	8.4x	5.6x	7.4x

\* Reflects adjustment for Dimension Data  
*Discounted Cash Flow Analysis*

NeXtAdvisors performed a discounted cash flow analysis of the ICS Business based upon estimates provided by management, including forward looking estimates relating to standalone costs for the ICS Business (including, without limitation, annual estimated corporate costs of operating the ICS Business as a stand-alone company of approximately \$1.55 million in 2011 and inflating at 3% per year thereafter). For the second, third, and fourth quarters of fiscal year 2011 and for fiscal years 2012, 2013, and 2014, respectively, after-tax unlevered free cash flow estimates for the ICS Business of \$0.9, \$1.4, \$1.8, \$14.1, \$10.8, and \$14.4 million, were utilized. For purposes of the analysis, NeXtAdvisors assumed a 35% standalone corporate tax rate. NeXtAdvisors calculated an implied range of terminal values for the ICS Business using a range of exit multiples of EBITDA from 4.0x to 7.0x. The unlevered free cash flows were then discounted to present values using a range of discount rates from 40.0% to 50.0%, which were derived based on substantial risks in the ICS Business. Most notably, there are significant risks associated with the ICS Business almost entire dependence on Cisco Systems, Inc. as a result of, among other things, the ICS Business reliance on Cisco's technology, product positioning, pricing, and discounting strategies. This was highlighted in the first and second quarters of 2010, when the ICS Business lost two clients as a result of acquisition-related and corporate level decisions to switch from Cisco to other competitors' platforms. An additional factor considered in determining the discount rate range is the inherent difficulty projecting financial performance, particularly the product resale portion of the ICS Business. This issue has been experienced in recent quarter performance and near-term forecast revisions, which have seen significant positive and negative deviations from original forecasts. The discounted cash flow analysis indicated the following approximate enterprise value reference ranges for the ICS Business, as compared to the purchase price of \$40.85 million:

(\$ Millions)	Low	High
Discounted Cash Flow	\$ 37.4	\$ 60.8

*Engagement of NeXtAdvisors*

NeXtAdvisors is a strategic advisory firm and is regularly engaged in the valuation of businesses and their securities in connection with mergers and acquisitions and private placements. With more than 20 years of experience, the principals of NeXtAdvisors have collectively completed more than 280 transactions totaling over \$41 billion in value across a diverse industry spectrum. The amount of consideration to be paid to eLoyalty was determined by negotiation between eLoyalty and TeleTech, not by recommendation of NeXtAdvisors. Our board of directors retained NeXtAdvisors to render the opinion because of its substantial experience in transactions similar to the proposed transaction, its knowledge of the ICS Business, and the terms under which NeXtAdvisors proposed to undertake the engagement.

NeXtAdvisors was retained by means of an engagement letter dated June 8, 2010 (as amended as of February 24, 2011). We have agreed to pay NeXtAdvisors an aggregate fee of 1.5% of the aggregate transaction consideration, which is contingent on the completion of the transaction. In addition, we agreed to pay NeXtAdvisors an initial retainer fee of \$25,000 and an opinion fee of \$250,000 upon delivery of its fairness opinion, neither of which is contingent upon consummation of the proposed transaction. The initial retainer fee and opinion fee are both fully creditable against the aggregate fee above. eLoyalty also agreed to reimburse NeXtAdvisors for its reasonable out-of-pocket expenses and to indemnify NeXtAdvisors against certain

liabilities arising from its engagement. Other than this engagement, during the prior two years, NeXtAdvisors has not had any material relationship with any party to the proposed transaction for which compensation has been received or is intended to be received, nor is any such material relationship or related compensation contemplated.

### **Governmental and Regulatory Approvals**

Neither eLoyalty nor TeleTech is aware of any regulatory approvals required to be obtained, or waiting periods to expire, to complete the sale of the ICS Business to TeleTech. If the parties discover that approvals or waiting periods are necessary, then they will seek to obtain or comply with them.

### **Certain U.S. Income Tax Consequences**

The following is a summary of certain United States income tax consequences to the Company and our stockholders on the sale of the ICS Business. The summary regarding the United States federal income tax consequences is based on the United States Internal Revenue Code of 1986, as amended (the Code), the regulations promulgated thereunder, and existing interpretations thereof as of the date hereof, all of which are subject to change, possibly with retroactive effect.

No ruling has been sought, and no opinion of counsel has been received, as to the tax treatment of the sale of the ICS Business to us or our stockholders, and the discussion herein is not binding on the Internal Revenue Service or any other taxing authority or any court of competent jurisdiction.

Unless otherwise stated herein, this discussion does not address state, local, non-U.S., or non-income tax consequences to us or our stockholders. The discussion also does not address different tax consequences that may result with respect to future transactions or distributions by the Company. Stockholders should consult with their own tax advisors if they want to better understand the tax consequences of the sale of the ICS Business.

### ***Stockholders***

The sale of the ICS Business should not result in any current United States federal income tax consequences to our stockholders.

### ***eLoyalty***

#### ***General***

We expect to recognize a gain for United States federal income tax purposes on the sale of the ICS Business. However, based on the results of an analysis that we have undertaken with the assistance of our tax advisors, we expect that for United States federal income tax purposes all or substantially all of the taxable gain resulting from the sale of the ICS Business will be offset by available net operating losses. Depending upon several factors, the current use of net operating losses to offset the gain on the sale of the ICS Business may result in the Company incurring more United States federal income taxes in subsequent years than we would have incurred if we had not sold the ICS Business.

#### ***Alternative Minimum Tax***

Because of the rules in the Code regarding the use of net operating losses, we expect that the sale of the ICS Business will result in the Company incurring some United States federal alternative minimum tax in the year of the sale.

*State and Local Income Taxes*

Because of different state rules on the use of net operating losses, we expect that the sale of the ICS Business will result in the Company incurring state and local income taxes in the year of the sale.

**Effects on eLoyalty if the Sale of the ICS Business is Completed**

If the Proposal to Sell the ICS Business is approved by our stockholders at the Annual Meeting and the sale of the ICS Business is completed, we will sell the ICS Business to TeleTech and continue to operate our Behavioral Analytics Service Business Unit, which will be our only remaining business, and we will remain a public company.

**Post-Closing Business and Proceeds from the Sale of the ICS Business**

After giving effect to our payment of estimated transaction fees and expenses and before giving effect to purchase price adjustments set forth in the Acquisition Agreement, we estimate that the net cash proceeds from our sale of the ICS Business will be approximately \$38.9 million. The purchase price adjustments set forth in the Acquisition Agreement will cause the actual amount of net cash proceeds to vary from this estimate. The purchase price adjustments will require that we transfer cash with the ICS Business at closing representing certain net managed services amounts (generally, unearned revenue less prepaid expenses), which amounts were equal to approximately \$11.7 million as of January 1, 2011.

Upon the closing of the sale of the ICS Business, our board of directors and management will focus their attention on our Behavioral Analytics Service Business Unit, which will be our only remaining business. We intend to analyze possibilities for enhancing our Behavioral Analytics Service Business Unit that may have been less available to us, due to resource issues or otherwise, when we operated both the ICS Business and the Behavioral Analytics Service Business Unit.

Our goals following the conclusion of the sale of the ICS Business will be to continue to grow and diversify revenue in our Behavioral Analytics Service business and improve gross margin. To achieve growth, we plan to implement distribution strategies that may include expanding our U.S. direct sales capabilities, studying international expansion possibilities, and considering strategic partnerships. We also intend to implement certain product strategies that may include deploying distinct new applications, such as customer attrition, back office, and fraud prevention.

Upon the closing of the sale of the ICS Business, we will face a number of risks and uncertainties. The ICS Business has historically accounted for a substantial portion of our revenues. Without that source of revenue, there will be additional pressure on our Behavioral Analytics Service business to grow revenues and achieve profitability. Our Behavioral Analytics Service business has never been profitable and we cannot provide you any assurance regarding when or if the Behavioral Analytics Service business will achieve profitability. After the closing of the sale of the ICS Business, we will be a small public company with a substantial cash balance. This may make us an attractive takeover target and we may be subject to unsolicited bids, which could become distracting to management and may ultimately not be in the best interests of our stockholders.

The closing of the sale of the ICS Business will constitute a liquidation under the terms of the Series B Designations. As a result, the holders of Series B Stock will be entitled to receive a liquidation preference of approximately \$19.4 million before any dividends or distributions could be made to the holders of Common Stock. We currently expect to pay approximately \$1.3 million of the liquidation preference, which amount represents dividends in arrears, immediately following the closing. TCV, the holder of a majority of the outstanding Series B Stock, has expressed its position, both directly and through outside legal counsel, that a cash payment equal to the full amount of the liquidation preference is due to the holders of Series B Stock immediately upon the closing of the proposed sale of the ICS Business. SHV, which through its affiliates holds approximately 38% of the outstanding Series B Stock, has informed us that it does not agree with TCV's position. Based on the advice of our legal counsel, we do not believe that the Series B Designations specify the

time period or manner in which the liquidation preference is to be paid to the holders of Series B Stock following the sale of the ICS Business. We believe that a payment of all or any portion of the liquidation preference requires a determination that the Company has funds available for distribution under state law and that a distribution is in the best interests of the Company's stockholders as a whole. We also believe that, prior to any distribution being made, the Series B Designations should be amended to clarify, among other things, whether a partial payment would reduce the liquidation preference and to specify the effect of a full payment of the liquidation preference on the future dividend and priority rights of the Series B Stock. An amendment to these provisions of the Series B Designations would require the consent of a majority of the outstanding Series B Stock.

In December 2010, our board of directors formed a Special Committee to review and evaluate the potential uses of proceeds from the proposed sale of the ICS Business and engage in discussions with the holders of Series B Stock. Our board of directors determined to designate the Special Committee because certain members of the board are holders of Series B Stock or may be deemed affiliates of holders of Series B Stock. The members of the Special Committee, Messrs. Mullen, Kohler, and Staley, are disinterested directors who do not, directly or indirectly, hold any shares of Series B Stock. The Special Committee has initially recommended to the board that, based on an analysis of expected net proceeds under various assumptions and a review of Behavioral Analytics' projections, an immediate distribution to stockholders with net proceeds from the sale of the ICS Business would not be advisable and in the best interests of the Company's stockholders as a whole. Following this recommendation, our board determined to designate the Special Committee as a standing committee for the purposes of, among other things, assessing from time to time whether eLoyalty has available funds for a full or partial distribution of the liquidation preference to the holders of Series B Stock and continuing to engage in related discussions and negotiations with the holders of Series B Stock.

Through the Special Committee, we are continuing to discuss with TCV and other holders of Series B Stock the timing and manner of any distributions to the holders of Series B Stock following the closing of the proposed sale. No assurance may be given that we will reach a mutually agreeable resolution of these matters prior to closing. On April 26, 2011, we entered into an agreement with TCV providing that, subject to certain conditions, we and TCV will submit to a final and binding arbitration in the Court of Chancery of the State of Delaware no later than 45 days following the closing of the sale of the ICS Business in the event that the parties have not reached a resolution prior to such time. During the pendency of any arbitration, we agreed to maintain cash and cash equivalents in an amount sufficient to pay in full the liquidation preference on the Series B Stock. While we believe that our disagreement with TCV's position has a substantial legal basis, we are unable to predict the outcome of any arbitration proceedings that may be instituted following the closing of the proposed sale and do not provide any assurances in this regard. The outcome of any arbitration proceedings may have a material adverse effect on our remaining business.

#### **Effects on eLoyalty if the Sale of the ICS Business is Not Completed**

If the sale of the ICS Business is not completed as currently contemplated by the Acquisition Agreement, we would continue to conduct our business as currently conducted and would evaluate all available strategic alternatives. If the Acquisition Agreement is terminated under certain specified circumstances, we might be required to pay TeleTech a termination fee of \$1.5 million and/or reimburse TeleTech for its reasonable out-of-pocket expenses in an amount not to exceed \$500,000.

#### **No Appraisal or Dissenters' Rights**

Stockholders who do not approve the Proposal to Sell the ICS Business may vote against the proposal, but under the General Corporation Law of the state of Delaware, appraisal and dissenters' rights are not provided to stockholders in connection with this action.

### **Interests of Certain Persons in the Sale of the ICS Business**

In considering the recommendation of our board of directors with respect to the Acquisition Agreement, our stockholders should be aware that our directors and executive officers have interests in the sale of the ICS Business that are different from, or in addition to, the interests of our stockholders generally. Our board of directors was aware of these interests and considered them in adopting the Acquisition Agreement and approving the sale of the ICS Business and recommending that our stockholders approve the sale of the ICS Business.

#### ***Employment Agreement with Mr. Pollema***

The sale of the ICS Business constitutes a change of control under the terms of the current employment agreement with Steven C. Pollema, our Vice President, Integrated Contact Solutions Business Unit. Mr. Pollema's employment agreement provides that a failure by eLoyalty to assign his agreement in connection with a change of control would give rise to the right of Mr. Pollema to terminate his agreement for good reason and receive severance as described under the terms of his agreement. Mr. Pollema has executed a termination letter with respect to his existing employment agreement with eLoyalty and entered into a new employment agreement with TeleTech, each of which is contingent upon the closing of the sale of the ICS Business. Under the terms of Mr. Pollema's new employment agreement with TeleTech, Mr. Pollema will be entitled to receive from TeleTech a minimum base salary, an annual bonus incentive, restricted stock units, severance compensation for certain termination events, and other customary benefits for an agreement of this type.

#### ***Performance Unit Awards held by Mr. Pollema***

In November 2009, Mr. Pollema was awarded 15,000 performance units under our 1999 Stock Incentive Plan. The sale of the ICS Business constitutes an acceleration event for these performance units that may require a payment to Mr. Pollema. The value of the aggregate incentive pool, of which Mr. Pollema is entitled to approximately 17%, is equal to 15% of the amount by which the net purchase price (as defined under the program) for the ICS Business exceeds \$36 million. The actual amount of the incentive pool will be determined by the Compensation Committee of the board (the Compensation Committee) following completion of the sale under the terms of the program. Any distribution approved by the Compensation Committee will be settled in shares of Common Stock, with the number of shares being determined by dividing the ultimate value of the incentive pool, if any, by the 10-day average closing price of the Common Stock as of the distribution date.

#### ***Employment Agreement with Mr. Conway***

The sale of the ICS Business constitutes a change of control under the terms of the employment agreement with Kelly Conway, our President and Chief Executive Officer. Mr. Conway's employment agreement provides that, upon a change of control, the vesting of his restricted stock awards and stock option grants shall be accelerated for a period of three years following the change of control. If the sale of the ICS Business closes as proposed, Mr. Conway would be entitled to vesting of 476,278 shares of Common Stock and 31,250 options. The sale of the ICS Business would also constitute good reason under the terms of the employment agreement, which would allow Mr. Conway to terminate his employment and receive severance.

On April 26, 2011, we entered into an amended employment agreement with Mr. Conway that includes a waiver of certain rights that would otherwise arise upon the closing of the proposed sale of the ICS Business. Specifically, Mr. Conway agreed to waive his good reason severance rights and the accelerated vesting with respect to 265,028 shares of restricted stock. In view of the reduction in the size and scope of the Company's operations following the sale of the ICS Business, the amended employment agreement includes a reduction in Mr. Conway's contractual base salary from \$480,000 to \$300,000 and a reduction in his target bonus amount from 110% of base salary to a fixed amount of \$300,000. The amended employment agreement also provides for changes in Mr. Conway's cash severance and death/disability benefits from formula amounts to fixed amounts of \$1,200,000 and \$800,000, respectively. Finally, in consideration of these changes and in recognition of Mr. Conway's significant efforts in connection with the proposed sale transaction, the amended employment

agreement provides for a transaction bonus, payable to Mr. Conway upon the closing of the proposed sale, equal to \$90,000 in cash and 50,000 options to purchase our common stock. Mr. Conway's amended employment agreement will not become effective unless the sale of the ICS Business closes as currently proposed.

#### ***Series B Stock Liquidation Preference***

Mr. Tench Coxe, Chairman of our board of directors, is managing director of the general partner of Sutter Hill Ventures, which together with its affiliates currently holds approximately 37% of our outstanding Series B Stock. Mr. Coxe may be deemed to have beneficial ownership of such Series B Stock under the rules and regulations of the SEC. Certain of our other directors hold shares of Series B Stock in amounts representing less than 1% of the total outstanding Series B Stock. The closing of the sale of the ICS Business will constitute a liquidation under the terms of the Series B Designations. As a result, the holders of Series B Stock will be entitled to receive a liquidation preference of approximately \$19.4 million before any dividends or distributions could be made to the holders of Common Stock. Of this amount, we currently expect to pay approximately \$1.3 million, representing dividends in arrears, immediately following the closing. In addition, our board of directors has designated a Special Committee for the purposes of, among other things, assessing from time to time whether eLoyalty has available funds for a full or partial distribution of the remaining liquidation preference to the holders of Series B Stock, and continuing to engage in related discussions and negotiations with TCV, the holder of a majority of the outstanding Series B Stock, and the other holders of Series B Stock. See *PROPOSAL #1: PROPOSAL TO SELL THE ICS BUSINESS Post-Closing Business and Proceeds from the Sale of the ICS Business*.

#### ***Voting Agreement***

Our directors, executive officers, and certain stockholders have entered into voting agreements with TeleTech, dated as of March 17, 2011, the forms of which are attached hereto as *Annex B*. See *PROPOSAL #1: PROPOSAL TO SELL THE ICS BUSINESS Terms of the Voting Agreements*.

#### ***Terms of the Acquisition Agreement***

The following is a summary of the material terms of the Acquisition Agreement. This summary does not purport to describe all the terms of the Acquisition Agreement and is qualified by reference to the complete Acquisition Agreement, which is attached to this proxy statement as *Annex A* and which we incorporate into this proxy statement by reference. We urge you to read the Acquisition Agreement carefully and in its entirety because it, and not the summary set forth in this proxy statement, is the legal document that governs the sale of the ICS Business.

The terms of the Acquisition Agreement (such as the representations and warranties) are intended to govern the contractual rights and relationships, and allocate risks, between the parties in relation to the sale of the ICS Business. The Acquisition Agreement contains representations and warranties that we, on the one hand, and TeleTech, on the other hand, made to each other as of specific dates. The representations and warranties were negotiated between the parties with the principal purpose of setting forth their respective rights with respect to their obligations to consummate the sale of the ICS Business, as well as their indemnity rights, and may be subject to important limitations and qualifications as set forth therein, including a contractual standard of materiality different from that generally applicable under federal securities laws. In addition, certain representations and warranties relate to information that is not known currently by either party and have been negotiated such that the risk that such representations or warranties are ultimately shown to not be true is allocated between the parties.

In addition, such representations and warranties are qualified by information in confidential disclosure schedules that we provided TeleTech in connection with signing the Acquisition Agreement. While we do not believe that the disclosure schedules contain information which has not been previously publicly disclosed and that the securities laws require to be publicly disclosed, the disclosure schedules do contain information that

modifies, qualifies, and creates exceptions to the representations and warranties set forth in the attached Acquisition Agreement. Accordingly, you should not rely on the representations and warranties as characterizations of the actual state of facts because they are modified by the underlying disclosure schedules. These disclosure schedules contain certain information that has been included in our prior public disclosures, as well as additional non-public information. Moreover, information concerning the subject matter of the representations and warranties may have changed since the date of the Acquisition Agreement, which subsequent information may or may not be fully reflected in our public disclosures.

***General; Purchase Price***

Pursuant to the terms of the Acquisition Agreement, upon the closing of the sale of the ICS Business, TeleTech will make a cash payment of \$40,850,000 to the Company, subject to the adjustments described below. Of the total purchase price, \$1,500,000 will be funded into an escrow account to satisfy our obligations, if any, under any indemnity claims that may be made by TeleTech.

The purchase price is subject to adjustment based on a managed services amount (generally, unearned revenue less prepaid expenses) as of the closing date, which we will be required to transfer with the ICS Business. The purchase price will also be adjusted to the extent the ICS Business's working capital ratio (generally, the ratio of current assets, excluding prepaid cost deferrals, to current liabilities, excluding unearned revenue) is greater or less than 1.21 as of the closing date. The purchase price will initially be adjusted at closing based upon the financial statements of the ICS Business as of the last day of the prior fiscal month. The purchase price will be further adjusted within 60 days of the closing date to reflect any increases or decreases of the Managed Service amount or working capital ratio based on the financial statements of the ICS Business as of the closing date. If we dispute TeleTech's calculations within 20 days of our receipt of such calculations, and any such dispute cannot be resolved within 10 days, then the disputed calculations will be submitted to an independent accounting firm for final determination.

***Scope of Purchased Assets, Excluded Assets, Assumed Liabilities, and Excluded Liabilities***

The assets we propose to sell to TeleTech consist of substantially all of the assets of the ICS Business, including, without limitation, the following assets (to the extent they are necessary for or primarily used in the ICS Business): all accounts receivable; all pre-paid cost deferrals relating to the ICS Business; certain assumed real property leases; certain equipment (leased and owned); certain assumed contracts; all rights to causes of action, lawsuits and similar claims (except to the extent they relate to excluded assets or retained liabilities) relating to the ICS Business; intellectual property (including the registered trademark / trade name eLoyalty); all books and records; all goodwill relating to the ICS Business; certain licenses and permits; cash and cash equivalents in an amount equal to the amount of the working capital and managed services adjustments described above; insurance proceeds relating to any purchased assets (to the extent the corresponding liability is an assumed liability); and all equity interests in eLoyalty International Limited (our wholly-owned Irish subsidiary, referred to in this proxy statement as the Irish Sub).

Certain of our assets are specifically excluded from the purchased assets pursuant to the terms of the Acquisition Agreement, including the following assets: intercompany accounts receivable; assets used in connection with the continuing business (provided that such assets are not necessary for or primarily related to the ICS Business); assets relating to our benefit plans; assets primarily related to retained liabilities; intellectual property unrelated to the ICS Business; certain real property interests; equity interests in all of our subsidiaries other than the Irish Sub; certain licenses and permits; insurance policies (other than proceeds thereunder relating to purchased assets); and certain marketing materials.

Under the terms of the Acquisition Agreement, TeleTech will assume certain liabilities relating to the ICS Business, including the following liabilities: obligations under the executory portion of assumed contracts; certain liabilities relating to transferred employees; certain obligations associated with unearned revenue relating to assumed contracts; certain employment and payroll taxes relating to transferred employees; certain taxes related to

the Irish Sub; certain real and personal property taxes relating to the purchased assets; and certain environmental liabilities relating to the assumed real property leases. TeleTech will not assume the following retained liabilities: any liability relating to the excluded assets; certain liabilities related to benefit plans; our liabilities arising under the Acquisition Agreement; all indebtedness for borrowed money; environmental liabilities not related to assumed real property leases; certain liabilities related to current and former employees; certain taxes; accounts payable relating to contracts that are not assumed by TeleTech; and liabilities related to indebtedness.

***Closing***

Closing of the sale of the ICS Business under the Acquisition Agreement will occur on the date that is the Company's first month-end for accounting purposes following the satisfaction or waiver of all conditions to the obligations of the parties to consummate the transactions contemplated thereby, including the adoption and approval of the sale of the ICS Business and the Acquisition Agreement by the holders of a majority of shares of eLoyalty Stock outstanding and entitled to vote at the Annual Meeting, or at such other time as we and TeleTech may agree upon in writing.

***Representations and Warranties***

The Acquisition Agreement contains a number of customary representations and warranties applicable to us, subject in some cases to customary qualifications, relating to, among other things, the following:

our valid existence and good standing, and other corporate matters;

authorization, valid execution and delivery, and enforceability of the Acquisition Agreement;

binding effect of the Acquisition Agreement and the other agreements contemplated thereby;

conflicts or violations under charter documents, contracts and instruments of law;

governmental consents, permits, approvals and filings required in connection with the sale of the ICS Business;

title, condition, and sufficiency of the purchased assets;

equipment related to the ICS Business;

receivables in respect of the ICS Business;

delivery and accuracy of financial statements related to the Company and the ICS Business;

filing and accuracy of the Company's SEC reports;

tax matters related to the ICS Business and the Irish Sub;



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absence of certain changes to the ICS Business since September 25, 2010;

absence of undisclosed liabilities;

pending or threatened litigation related to the Company or the purchased assets;

real property leases related to the ICS Business;

material contracts related to the ICS Business;

licenses and permits related to the ICS Business;

liabilities related to products sold and services provided by the ICS Business;

compliance with laws applicable to the ICS Business;

environmental matters related to the assumed real estate leases;

intellectual property matters related to the ICS Business;

software used in or related to the ICS Business;

insurance matters related to the ICS Business;

labor and employee benefit matters related to the ICS Business;

customers and suppliers related to the ICS Business;

transactions between the Company and its affiliates in respect of the ICS Business;

brokers or finders fees, and other fees with respect to the sale of the ICS Business;

our board's approval of the sale of the ICS Business and the Acquisition Agreement;

requisite stockholder approval of the sale of the ICS Business;

solvency of the Company after giving effect to the sale of the ICS Business;

opinion of financial advisor;

information contained in this proxy statement; and

matters with respect to government contracts related to the ICS Business.

Certain representations and warranties in the Acquisition Agreement provide exceptions for items that are not reasonably likely to have a Material Adverse Effect. For purposes of the Acquisition Agreement, a Material Adverse Effect means any material adverse effect, circumstance, or change, or any violation or other matter, if such material adverse effect, circumstance, change, violation, or other matter, either individually or in the aggregate with all other effects, circumstances, changes, violations or other matters, has or could reasonably be expected to have (either before or after the closing of the sale of the ICS Business), a material adverse effect on the business, prospects, assets, condition (including financial condition) or results of operations of the ICS Business, taken as a whole, but excluding any effect, circumstance, change, violation, or other matter to the extent directly resulting from or directly attributable to any of the following:

economic effects or changes that are generally applicable to the industries or markets in which the ICS Business operates (except to the extent such effect or change disproportionately affects the ICS Business);

general changes in the United States or world financial markets or general economic conditions (except to the extent such change disproportionately affects the ICS Business);

any adverse change, event, development or effect arising from or relating to (i) any laws or regulatory conditions issued by any governmental authority that does not relate only to the ICS Business or (ii) any changes in generally accepted accounting principals

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or other accounting requirements or principles or interpretation thereof;

the announcement, pendency, or consummation of the transactions contemplated by the Acquisition Agreement;

actions or omissions of the Company or any of its subsidiaries that are taken after the date of the Acquisition Agreement and required thereby or taken with the prior written consent of TeleTech; and

the commencement or continuation of a natural disaster, war, armed hostilities, acts of terrorism, or any other local, international, or national calamity, whether or not involving the United States (except to the extent such occurrence disproportionately affects the ICS Business).

If any material adverse effect, circumstance, change, violation, or other matter relating to the financial condition or results of operations of the ICS Business taken as a whole, in the aggregate with all other such effects, circumstances, changes, violations, or other matters, could not reasonably be expected to result in (i) losses or liability to TeleTech of \$750,000 or more in the aggregate within 12 months after the closing date or (ii) EBITDA, as defined in the Acquisition Agreement, for any twelve month period ending at the end of a calendar quarter during 2011 equaling no more than 92.5% of EBITDA for the corresponding twelve month

period ended at the end of the corresponding calendar quarter during 2010, then such effect, circumstance, change, violation, or other matter will not be deemed a Material Adverse Effect; provided, however that if the results in (i) or (ii) could be reasonably expected, then such effect, circumstance, change, violation, or other matter will be deemed a Material Adverse Effect.

The Acquisition Agreement also contains a number of customary representations and warranties applicable to TeleTech, subject in some cases to customary qualifications, relating to, among other things, the following:

TeleTech's corporate organization, valid existence and good standing, and other corporate matters;

authorization, valid execution and delivery, and enforceability of the Acquisition Agreement;

binding effect of the Acquisition Agreement and the other agreements contemplated thereby;

conflicts or violations under charter documents, contracts, and instruments of law;

governmental consents, permits, approvals, and filings required in connection with the sale of the ICS Business;

brokers' or finders' fees, and other fees with respect to the sale of the ICS Business;

sufficiency of funds; and

pending or threatened material litigation.

***Covenants and Agreements***

***Conduct of ICS Business Prior to Closing***

Under the Acquisition Agreement, we have agreed that, until the closing of the sale of the ICS Business or the earlier termination of the Acquisition Agreement, except as expressly contemplated by the Acquisition Agreement or as set forth in the confidential disclosure schedules to the Acquisition Agreement, we will operate the ICS Business in the ordinary course of commercial operations customarily engaged in by the ICS Business consistent with past custom and practice and will use commercially reasonable efforts to:

maintain insurance in such amounts and against such risks and losses as are consistent with past practice and apply all insurance proceeds received with respect to claims made for the purchased assets to replace or repair, as applicable, such purchased assets;

preserve intact all business organizations in respect of the ICS Business;

keep available the services of the current officers and employees of the ICS Business;

preserve the ICS Business's relationships with customers, creditors, and suppliers;

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maintain books, accounts, and records in respect of the ICS Business; and

comply with any applicable laws.

We have also agreed that, until the closing of the sale of the ICS Business or the earlier termination of the Acquisition Agreement, except as expressly contemplated by the Acquisition Agreement, as set forth in the confidential disclosure schedules to the Acquisition Agreement, as required by applicable law, or as consented to by TeleTech, we will not:

amend any of our organizational documents in any manner which could reasonably be expected to adversely affect the sale of the ICS Business;

merge or consolidate with any entity or acquire any interest in any business or entity that in any manner could reasonably be expected to adversely affect the sale of the ICS Business;

liquidate, dissolve, or effect any recapitalization or reorganization in any form;

sell, lease, license, transfer, encumber, or otherwise dispose of any of the purchased assets or any interests therein that are material, individually or in the aggregate, to the ICS Business, except for such assets or interests therein that are used, consumed, performed, replaced, or sold in the ordinary course of business or permitted encumbrances;

create, incur, assume, or suffer to exist any new encumbrance (except permitted encumbrances) affecting any of the purchased assets;

change any of our accounting principles or practices used in the preparation of financial statements, or revalue or reclassify in any material respect any of the purchased assets or assumed liabilities, except as required by generally accepted accounting principles;

change in any material respect our pricing policies or credit practices, the rate or timing of our payment of accounts payable or our collection of accounts receivable or change our earnings accrual rates on contracts, except as required by generally accepted accounting principles;

fail to pay any creditor any amount owed to such creditor in the ordinary course of business in accordance with our business practices, unless such amount is being contested or disputed in good faith;

enter into or renew any contract with or engage in any transaction with any affiliate for which TeleTech could have any liability;

make any capital investment in, any loan to or any acquisition of the securities or assets of any other person (or series of related capital investments, loans, and acquisitions) which could reasonably be expected, individually or in the aggregate, to adversely affect any of the purchased assets;

except for the purchase of supplies in the ordinary course of business, make any capital expenditures or commitments for capital expenditures involving more than \$50,000 in respect of the ICS Business;

enter into, terminate, renew, amend in any material respect, or waive any material right under, any material contract, except in the ordinary course of business;

take or fail to take any action that will cause a termination of or material breach or default under any material contract;

make or change any material tax election, settle or compromise any material tax liability, file any amendment to a tax return, settle any material claim or material assessment in respect of taxes or consent to any extension or waivers of the limitation period applicable to any material claim or assessment in respect of taxes, or change in any respect any accounting method in respect of taxes, with respect to the ICS Business or the purchased assets, subject to certain limited exceptions;

settle or compromise any pending or threatened legal proceeding for more than \$50,000 in any way that would have any adverse impact upon, or create any material liability for, TeleTech or, after the closing, the ICS Business;

except as required by applicable law, in accordance with the terms of any benefit plan, or with respect to any individual who will not become an employee of TeleTech, (i) grant any severance, retention or termination pay to, or amend any existing severance, retention or termination arrangement with, any current or former manager, officer, employee or any agent of the ICS Business, (ii) increase or accelerate the payment or vesting of benefits payable under any existing severance, retention or termination pay policies or employment agreements, (iii) enter into or amend any employment, consulting, deferred compensation or other similar

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agreement with any manager, officer, or consultant of the ICS Business, other than execution of our standard employment terms and conditions by new employees in the ordinary course of business, (iv) establish, adopt, or amend any collective bargaining agreement, bonus, profit-sharing, thrift, pension, retirement, post-retirement medical or life insurance, retention, deferred compensation, compensation, stock option, restricted stock, or other benefit plan or arrangement covering any present or former manager, director, officer, or employee, or any beneficiaries thereof, of the ICS Business, (v) undertake any office closing or employee layoffs, except

in the ordinary course of business, or (vi) increase the compensation, bonus, or other benefits payable or to become payable to any manager, director, or officer or employee of the ICS Business, except in the ordinary course of business;

cancel or fail to renew all current insurance policies in respect of the ICS Business at the same limits in effect as of the date of the Acquisition Agreement up to and through the closing date;

take or fail to take any action that may have any adverse impact upon, or create any material liability for, TeleTech or the ICS Business relating to the infringement of any intellectual property right of any other person; or

agree, resolve or commit to do any of the foregoing or any other action that would be reasonably likely to cause any of the conditions to the consummation of the transactions contemplated by the Acquisition Agreement to not be satisfied.

*Solicitation of Other Offers and Restrictions on Solicitations of Other Offers*

The Acquisition Agreement provides that, until the closing of the sale of the ICS Business or the earlier termination of the Acquisition Agreement, we will not (nor will we authorize or permit any of our representatives, affiliates, subsidiaries, officers, directors, employees, or advisors to):

directly or indirectly solicit, initiate, or encourage the submission of any Acquisition Proposal (as defined below);

enter into any letter of intent, agreement in principle, acquisition agreement, or any other similar agreement with respect to any Acquisition Proposal (each, a Third Party Acquisition Agreement ); or

directly or indirectly participate in any discussions or negotiations regarding, or furnish to any person any non-public information with respect to, or knowingly take any other action to facilitate any inquiries or the making of any proposal that constitutes, or may reasonably be expected to lead to, any Acquisition Proposal.

Notwithstanding the restrictions set forth above, until receipt of the requisite stockholder approval of the Acquisition Agreement, we may, in response to an unsolicited Acquisition Proposal that does not result in a breach of the restrictions set forth above, (i) furnish information to the person making such Acquisition Proposal pursuant to a customary confidentiality and standstill agreement not less restrictive than the confidentiality agreement between us and TeleTech related to the sale of the ICS Business and (ii) participate in discussions or negotiations with such person regarding any Acquisition Proposal, if our board (a) believes in good faith the Acquisition Proposal to be bona fide, (b) determines in good faith (after consultation with outside legal counsel and a qualified financial advisor) that the unsolicited Acquisition Proposal constitutes or would reasonably be expected to lead to a Superior Proposal (as defined below), (c) determines that the failure to take any of the above actions would not be consistent with its fiduciary duties to our stockholders, and (d) provides to TeleTech, within 48 hours of receiving an Acquisition Proposal, the materials terms thereof along with the identify of the person making it. We must keep TeleTech reasonably informed of the status of any such Acquisition Proposal.

Neither our board nor any committee thereof will withdraw or modify, or propose publicly to withdraw or modify, in a manner adverse to TeleTech, its recommendation that our stockholders approve the Acquisition Agreement or approve or recommend or propose publicly to approve or recommend to our stockholders, or otherwise permit or cause the Company to accept or enter into, an Acquisition Proposal (any such action, an Adverse Recommendation Change ). In addition, the Company will not approve, recommend, publicly propose or enter into any Third Party Acquisition Agreement, nor, with certain exceptions, release any third party from, or waive any provisions of, any confidentiality and standstill agreement to which the Company is a party. Notwithstanding the foregoing, if our board, prior to receipt of the requisite stockholder approval of the Acquisition Agreement, (i) receives an Acquisition Proposal that does not result in a breach of the Acquisition Agreement and that it determines in good faith (after consultation with outside legal counsel and a qualified financial advisor) constitutes a Superior Proposal, and (ii) determines in good faith (after consultation with



outside legal counsel) that failure to take any of the following actions would not be consistent with its fiduciary duties to our stockholders, then the board may (a) make an Adverse Recommendation Change and/or (b) cause the Company to enter into a Third Party Acquisition Agreement with respect to such Superior Proposal, but only if we have concurrently with entering into such Third Party Acquisition Agreement terminated this Acquisition Agreement pursuant to its terms.

If our board determines to effect an Adverse Recommendation Change or to authorize the Company to enter into a Third Party Acquisition Agreement with respect to a Superior Proposal, we must provide written notice to TeleTech thereof, along with a copy of the Superior Proposal, at least five days prior to such Adverse Recommendation Change or Third Party Acquisition Agreement becoming effective; provided that any material amendment to the terms of such Superior Proposal after the initial notice will require us to provide a new notice to TeleTech and restart the five day period referred to above. In determining whether to effect an Adverse Recommendation Change or to cause the Company to enter into a Third Party Acquisition Agreement in response to a Superior Proposal, our board will negotiate in good faith with TeleTech (to the extent TeleTech desires to negotiate) with respect to any offer from TeleTech and take into account in good faith any changes to the terms of this Acquisition Agreement proposed by TeleTech (in response to an Adverse Recommendation Notice or otherwise) in determining whether such Acquisition Proposal still constitutes a Superior Proposal.

The term **Acquisition Proposal** means any written inquiry, proposal, or offer relating to a possible (i) amalgamation, merger, consolidation, tender offer, or similar transaction involving the ICS Business or the Company, other than an amalgamation, merger, consolidation, or similar transaction involving the Company but not involving the purchased assets or assets to which TeleTech receives benefit under the Transition Services Agreement; (ii) sale, lease, or other disposition, directly or indirectly (including by way of merger, consolidation, share, or unit exchange or otherwise) of any of the purchased assets or assets to which TeleTech receives benefit under the Transition Services Agreement, other than the sale, lease, or other disposition of the purchased assets used, consumed, replaced, or sold in the ordinary course of business; (iii) issuance, sale, or other disposition of (including by way of merger, consolidation, share, or unit exchange or otherwise) our securities (or options, rights, or warrants to purchase or securities convertible into, such securities) other than option grants to our employees in the ordinary course of business or any issuance, sale, or other disposition that will close after the sale of the ICS Business to TeleTech and which will not preclude the consummation of such sale; (iv) liquidation, dissolution, recapitalization, or other similar type of transaction with respect to the Company other than any of the purchased assets or assets to which TeleTech receives benefit under the Transition Services Agreement or any such transaction that will close after the sale of the ICS Business to TeleTech and which will not preclude the consummation of such sale; (v) transaction which is similar in form, substance, or purpose to any of the foregoing transactions; or (vi) public announcement of an agreement, proposal, plan, or intent to do any of the foregoing; provided, however, that the term **Acquisition Proposal** does not include (a) the transactions contemplated by the Acquisition Agreement or (b) any transaction not involving the purchased assets or assets to which TeleTech receives benefit under the Transition Services Agreement.

The term **Superior Proposal** means any bona fide Acquisition Proposal, including any Acquisition Proposal relating solely to the ICS Business, made by a third party (i) on terms which our board determines in good faith, after consultation with the Company's outside legal counsel and qualified financial advisors, to be more favorable from a financial point of view to our stockholders than the transactions contemplated by the Acquisition Agreement, taking into account all the terms and conditions of such proposal, and the Acquisition Agreement (including any proposal by TeleTech to amend the terms of the Acquisition Agreement and the transactions contemplated thereby), (ii) that is not subject to a financing condition (and if financing is required, such financing is then fully committed to the third party), (iii) that includes termination rights of the third party on terms no less favorable to the Company than the terms set forth in the Acquisition Agreement, and (iv) that, in the good faith, reasonable judgment of our board is reasonably capable of being completed, taking into account all financial, regulatory, legal, and other aspects of such proposal, without unreasonable delay, all from a third party capable of performing such terms.

*Stockholder Approval*

We agreed to hold a stockholders' meeting as soon as reasonably practicable following the execution of the Acquisition Agreement and the mailing of the related proxy statement for the purpose of voting on the approval of the sale of the ICS Business. Pursuant to the terms of the Acquisition Agreement, our board will use its reasonable, good faith efforts to obtain the approval of our stockholders of the sale of the ICS Business.

*Other Covenants and Agreements*

The Acquisition Agreement contains certain other customary covenants and agreements relating to, among other things:

the providing of notice information with respect to any matter arising after the execution of the Acquisition Agreement which, if existing or occurring prior to such execution, would have been required to be disclosed under the terms of the Acquisition Agreement;

the filing of this proxy statement with the SEC (and cooperation in response to any comments from the SEC with respect to such statement);

TeleTech's access to our properties, management, books, and records in respect of the ICS Business;

the parties' retention of business records relating to periods prior to the closing date for a period of six years after the execution of the Acquisition Agreement;

the giving of all required notices to third parties and governmental authorities, and the use of commercially reasonable efforts to obtain all licenses and permits, consents, waivers, approvals, authorizations, declarations, and filings that are required to consummate the transactions contemplated by the Acquisition Agreement;

affiliate agreements;

confidentiality;

the use of the eLoyalty mark and logo;

the delivery of monthly financial statements and a pre-closing financial statement in respect of the ICS Business;

the use of commercially reasonable efforts to cooperate with and assist TeleTech (i) in transferring all transferrable licenses and permits to TeleTech to the extent such licenses and permits are not necessary or desirable for the Company after the closing, (ii) in obtaining for TeleTech those licenses and permits as may be necessary to operate and conduct the ICS Business as now conducted or to occupy any premises in which the ICS Business is operated or conducted, (iii) in negotiating in good faith with the applicable third parties buyout agreements, early termination agreements, or similar agreements with respect to certain leased equipment, and (iv) in negotiating in good faith with the applicable third parties agreements regarding TeleTech's use after the closing of certain intellectual property and software licenses; and

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cooperation in good faith prior to the closing to amend and update certain exhibits to the Acquisition Agreement.

### ***Employee Matters***

On the closing date, TeleTech will make offers of employment to certain of our employees identified by them and listed on the confidential disclosure schedule to the Acquisition Agreement. Any such employee who accepts TeleTech's offer of employment and commences employment with TeleTech shall be referred to, individually, as a Transferred Employee and, collectively, as the Transferred Employees. Following the closing date, TeleTech will provide (i) to each Transferred Employee compensation at least equal to that provided by us to such Transferred Employee immediately prior to the closing date and (ii) to Transferred

Employees generally, employee benefits comparable, in the aggregate, to those provided by TeleTech to similarly situated employees of TeleTech. In addition, TeleTech has agreed, with certain exceptions, to take the following actions with respect to Transferred Employees: (a) waive any limitations regarding pre-existing conditions and eligibility waiting periods under any TeleTech benefit plans; (b) provide each Transferred Employee, to the extent commercially practicable, with credit for any payments toward out of pocket limits and deductibles paid prior to the closing date in satisfying any applicable deductible or out-of-pocket requirements under any TeleTech benefit plan; and (c) for eligibility and vesting purposes (but not benefit accruals) treat all service by the Transferred Employees with the Company before the closing date as service with TeleTech.

Pursuant to the terms of the Acquisition Agreement, we will remain responsible for the payment of all wages and other remuneration due to our employees with respect to their services as our employees prior to the closing date. TeleTech will not assume any obligations to any of our current or former employees, including but not limited to any obligations, commitments, or liabilities related to employment, compensation, severance, and benefits incurred on or prior to the closing date, except for certain non-benefit related liabilities reflected on the ICS Business's closing date balance sheet. We will hold TeleTech harmless from and against all direct and indirect costs, expenses, and liabilities of any sort arising from or relating to any claims by or on behalf of our employees with respect to liabilities under our benefit plans, severance pay, or termination pay, liabilities relating to consultation requirements with any works council or union, and transfers or undertakings in the applicable foreign jurisdiction, and similar obligations relating to the termination of such employees' employment with the Company. In addition, we agreed to terminate, waive, and release any rights or remedies that we may have with respect to the solicitation of employment or employment by TeleTech of any Transferred Employee, including any claims or rights we may have against TeleTech or any Transferred Employee under any non-hire, non-solicitation, non-competition, confidentiality, or employment agreement or any cause of action based on similar rights arising by contract, at common law, or by statute or regulation. In addition, we and TeleTech agreed to comply (and to cooperate in good faith to the extent necessary to permit each party to comply) with certain applicable federal, state, local, and foreign laws, rules and regulations regarding the transfer of employees.

***Conditions to the Sale of the ICS Business***

***Conditions to Each Party's Obligation***

Each party's obligation to complete the sale of the ICS Business is subject to the satisfaction or waiver of the following conditions:

there must exist no valid judicial order which prohibits the consummation of the transactions contemplated by the Acquisition Agreement; and

the sale of the ICS Business and the Acquisition Agreement must have been approved by the affirmative vote of holders of a majority of shares of eLoyalty Stock outstanding and entitled to vote at the Annual Meeting (sometimes referred to in this proxy statement as the requisite stockholder approval).

***Conditions to TeleTech's Obligation***

TeleTech's obligation to complete the sale of the ICS Business is subject to the satisfaction or waiver of certain conditions, including the following:

each of the representations and warranties made by us in the Acquisition Agreement must be true and correct in all respects without regard to any materiality qualifier thereon on and as of the closing date as though such representation or warranty was made on and as of the closing date (other than those made as of a specified date earlier than the closing date in which case each such representation or warranty shall have been so true and correct on and as of such earlier date), except for such failures to be true and correct as would not, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect;

we must have performed in all material respects all obligations required to be performed by us under the Acquisition Agreement at or prior to the closing;

all consents and approvals required under the Acquisition Agreement must have been obtained and in full force and effect;

EBITDA for the twelve month period ended on March 31, 2011 shall exceed \$8,000,000; and

we must have delivered to TeleTech (i) bills of sale, assignments, deeds, or other applicable documents of transfer necessary to effect the sale of the purchased assets, (ii) executed counterparts to the certain related agreements; (iii) a FIRPTA affidavit; (iv) clearance and bulk sales certificates with respect to any taxing jurisdiction requested by TeleTech; (v) the ICS Business Closing Date Balance Sheet (as defined in the Acquisition Agreement); (vi) an officer's certificate with respect to the satisfaction of the foregoing conditions relating to representations and warranties made, and obligations required to be performed, by us under the terms of the Acquisition Agreement; and (vii) such documentation as may be reasonably requested by TeleTech to vest good and valid title to the Irish Sub in a subsidiary of TeleTech.

*Conditions to Our Obligation*

Our obligation to complete the sale of the ICS Business is subject to the satisfaction or waiver of certain conditions, including the following:

the representations and warranties made by TeleTech in the Acquisition Agreement must be true and correct in all material respects on and as of the closing date as though such representation or warranty was made on and as of the closing date (other than those made as of a specified date earlier than the closing date in which case each such representation or warranty shall have been so true and correct on and as of such earlier date);

TeleTech must have performed in all material respects all obligations required to be performed by it under the Acquisition Agreement at or prior to the closing; and

TeleTech must have delivered to us (i) the purchase payment described above; (ii) executed counterparts to the Related Agreements; (iii) an officer's certificate with respect to the satisfaction of the foregoing conditions relating to representations and warranties made, and obligations required to be performed, by TeleTech under the terms of the Acquisition Agreement; and (iv) such other customary documents, instruments or certificates as shall be reasonably requested by us and as shall be consistent with the terms of the Acquisition Agreement.

***Termination of the Acquisition Agreement***

The Acquisition Agreement may only be terminated:

by mutual written consent of us and TeleTech;

by either us or TeleTech, if:

the closing shall not have occurred on or before July 3, 2011, provided that such right to terminate is not available to any party whose failure to perform any of its obligations under the Acquisition Agreement resulted in the failure of the closing to be so consummated by such date; or

any final, nonappealable order by a court of competent jurisdiction is issued which precludes the consummation of the closing or the transaction contemplated by the Acquisition Agreement or the Related Agreements (by injunction or otherwise), provided that such right to terminate is not available to a party if the issuance of such order was primarily due to the failure of such party to perform any of its obligations under the Acquisition Agreement;

by TeleTech, if:

the requisite stockholder approval is not obtained within 90 days after execution of the Acquisition Agreement by the parties;

an Adverse Recommendation Change occurs;

we willfully and materially breach the terms of the Acquisition Agreement dealing with third-party Acquisition Proposals in any respect adverse to TeleTech;

we intentionally or recklessly breach any representation or warranty, covenant, or agreement contained in the Acquisition Agreement, and such breach, individually or in combination with any other breach, would cause any of the conditions to TeleTech's obligation to complete the sale of the ICS Business not to be satisfied; or

in the course of us providing TeleTech information with respect to any matter arising after the execution of the Acquisition Agreement, any such information, individually or in the aggregate, could reasonably be expected to have a material adverse effect on the ICS Business; and

by us, if:

we enter into a Third Party Acquisition Agreement providing for a Superior Proposal, provided that we may only exercise this termination right if we have complied with certain relevant obligations under the Acquisition Agreement; or

TeleTech breaches any representation or warranty, covenant, or agreement contained in the Acquisition Agreement, and such breach, individually or in combination with any other such breach, would cause any of the conditions to our obligation to complete the sale of the ICS Business not to be satisfied.

***Termination Fees***

We must pay to TeleTech a fee equal to (i) \$1,500,000 plus (ii) all of TeleTech's reasonable out-of-pocket expenses, including all attorneys' fees, financial advisors' fees, accountants' fees, and filing fees (the Termination Expenses), up to an aggregate amount not to exceed \$500,000, in the following circumstances:

TeleTech terminates the Acquisition Agreement on the basis of an Adverse Recommendation Change;

TeleTech terminates the Acquisition Agreement on the basis of a willful and material breach by us of the terms of the Acquisition Agreement dealing with third-party Acquisition Proposals in any respect adverse to TeleTech; or

we terminate the Acquisition Agreement on the basis of our entry into a Third Party Acquisition Agreement providing for a Superior Proposal.

If TeleTech terminates the Acquisition Agreement on the basis that (i) the requisite stockholder approval is not obtained within 90 days after execution of the Acquisition Agreement by the parties or (ii) we intentionally or recklessly breach any representation or warranty, covenant, or agreement contained in the Acquisition Agreement, and such breach, individually or in combination with any other breach, would cause any of the conditions to TeleTech's obligation to complete the sale of the ICS Business not to be satisfied, then we will pay TeleTech a fee equal to the Termination Expenses.

*Noncompetition and Nonsolicitation*

In connection with the sale of the ICS Business, we have agreed that, for a period of five years after the closing date of the sale of the ICS Business, we will not and will cause our subsidiaries not to own an interest in, operate, join, control, advise, work for, consult to, have a financial interest that provides any control of, or participate in any person producing, designing, providing, soliciting orders for, selling, distributing, consulting to, or marketing or remarketing products or services competitive with or in substantially the same line of business as the ICS Business, or any part thereof, as of the closing date. Notwithstanding the foregoing, neither we nor our



affiliates are prohibited from (i) maintaining and/or undertaking passive investments in less than 5% of the outstanding stock of any publicly-traded corporation or (ii) engaging in the business operated by the Company and its subsidiaries as of the closing date (but immediately after giving effect to the sale of the ICS Business), and any other business incidental or relating thereto, including, among other things, (a) the provision of solutions to improve the reliability of call recording, (b) the process of employing human behavioral modeling to analyze and improve customer solutions and help optimize the performance of call center agents, (c) the process of employing human behavioral modeling and analytics in the areas of Fraud Analytics, Collections Analytics, Back Office Analytics, Predictive Modeling, Email Analytics, and Student Analytics, (d) the implementation and hosting of related hardware and software, and (e) the provision of related training and add-on consulting services.

In addition, we have agreed that, for a period of three years after the closing date of the sale of the ICS Business, we will not and will cause our subsidiaries not to take any action, formal or informal, direct or indirect, to induce any employee of TeleTech (or of any of its respective affiliates) to terminate his or her employment with TeleTech (or of any of its respective affiliates), or attempt to interfere with the relationship or prospective relationship between TeleTech (or of any of its respective affiliates) and any creditor, licensee, customer, prospective customer, employee, or other party. Notwithstanding the foregoing, we shall not be restricted from making general solicitations of employment (including the use of general advertisements and recruiting agencies) not specifically directed at the employees of TeleTech (or of any of its respective affiliates) and hiring any person (i) who responds thereto, or (ii) whose employment has been previously terminated by TeleTech (or of any of its respective affiliates).

### ***Indemnification***

Subject to the certain limitations set forth below, we must indemnify and hold harmless TeleTech and its managers, members, officers, and employees (in their capacity as such), and its and their affiliates and agents, against and in respect of any and all losses incurred directly or indirectly, in connection with, arising from or as a result of (i) any material breach of any of the covenants made in the Acquisition Agreement by us or any of our affiliates, (ii) any breach of any of the representations and warranties made in the Acquisition Agreement by us, (iii) the ownership, use, or possession of the excluded assets, (iv) the retained liabilities, (v) the ownership and operation of the continuing business following the closing of the sale of the ICS Business, or (vi) any fraud, intentional misrepresentation or criminal acts committed by or on behalf of us or any of our affiliates on or prior to the closing date of the sale of the ICS Business. In general, we are not obligated to make TeleTech whole for any losses suffered as a result of any breach of our representations or warranties or a material breach of our notification covenant until TeleTech suffers losses in excess of \$200,000, at which point we are obligated to indemnify the indemnified party to the full extent of all losses, subject to limitations set forth below. Notwithstanding the foregoing, we are obligated to indemnify TeleTech for all losses with respect to claims based upon breaches of representations and warranties relating to (a) authorization, valid execution and delivery, and enforceability of the Acquisition Agreement, (b) conflicts or violations under charter documents, contracts and instruments of law, (c) title and condition of the purchased assets, (d) taxes, and (e) brokers' or finders' fees. Our liability for any claim for indemnification brought by TeleTech based upon a breach of a representation or warranty or a material breach of our notification covenant is limited to \$2,000,000, except for indemnification claims based on fraud or any breach of a representation or warranty made in connection with breaches of the representations and warranties relating to (1) authorization, valid execution and delivery, and enforceability of the Acquisition Agreement, (2) conflicts or violations under charter documents, contracts and instruments of law, (3) title and condition of the purchased assets, (4) taxes, and (5) brokers' or finders' fees, for which there is no limit.

Subject to the certain limitations set forth below, TeleTech must indemnify and hold harmless us and our directors, stockholders, officers and employees (in their capacity as such), and their affiliates and agents against and in respect of any and all losses incurred directly or indirectly in connection with, arising from or as a result of (i) any material breach of any of the covenants made in the Acquisition Agreement by TeleTech or any of its respective affiliates, (ii) any breach of any of the representations or warranties made in the Acquisition Agreement by TeleTech, (iii) the assumed liabilities, (iv) the ownership and operation of the ICS Business

following the closing of the sale of the ICS Business (other than in respect of the retained liabilities), or (v) any fraud, intentional misrepresentation or criminal acts committed by or on behalf of TeleTech or any of its affiliates on or prior to the closing date of the sale of the ICS Business. TeleTech is generally not obligated to make us whole for any losses suffered as a result of any breach of its representations or warranties until we suffer losses in excess of \$200,000, at which point TeleTech is obligated to indemnify us to the full extent of all losses, subject to limitations set forth below. Notwithstanding the foregoing, TeleTech is obligated to indemnify us for all losses with respect to claims based upon breaches of representations and warranties relating to (a) authorization, valid execution and delivery, and enforceability of the Acquisition Agreement, (b) conflicts or violations under charter documents, contracts and instruments of law, (c) governmental consents, permits, approvals and filings required in connection with the sale of the ICS Business, and (d) brokers' or finders' fees. TeleTech's liability for any claim for indemnification brought by us based upon a breach of a representation or warranty is limited to \$2,000,000, except for indemnification claims based on fraud or any breach of a representation or warranty made in connection with breaches of the representations and warranties relating to (1) authorization, valid execution and delivery, and enforceability of the Acquisition Agreement, (2) conflicts or violations under charter documents, contracts and instruments of law, (3) governmental consents, permits, approvals and filings required in connection with the sale of the ICS Business, and (4) brokers' or finders' fees.

***Tax Matters***

Under the terms of the Acquisition Agreement, we and TeleTech will each pay or cause to be paid fifty percent (50%) of all transfer, documentary, sales, use, value-added, property, gross receipts, stamp, registration or other similar taxes incurred in connection with the transfer and sale of the purchased assets. In addition, we will pay TeleTech an amount equal to all taxes with respect to the Irish Sub that have accrued but were not paid before the closing date to the extent such taxes were not included as a liability on the ICS Business's balance sheet. TeleTech will pay all post-closing period taxes applicable to the ICS Business or the purchased assets and all assumed taxes.

We will prepare and file, or cause to be prepared and timely filed, all tax returns related to the Irish Sub, the ICS Business, and the purchased assets for all pre-closing tax periods. TeleTech will prepare and file, or cause to be prepared and timely filed, all tax returns related to the Irish Sub, the ICS Business, and the purchased assets for all post-closing tax periods.

We will receive the sole benefit of all refunds for taxes with respect to which the liabilities are either retained by us or assumed by TeleTech, including all refunds related to the Irish Sub for pre-closing tax periods. All refunds for post-closing tax periods applicable to the ICS Business or the purchased assets will be for the sole benefit of TeleTech. All refunds for transfer taxes will be for the equal benefit of the parties.

***Expenses***

Except as otherwise set forth in the Acquisition Agreement, each party will pay all costs and expenses incident to its negotiation and preparation of the Acquisition Agreement and to its performance and compliance with all agreements and conditions contained therein on its part to be performed or complied with, including the fees, expenses and disbursements of its counsel and accountants.

***Amendment and Waiver***

The Acquisition Agreement may be amended or waived if such amendment or waiver is in writing and signed, in the case of an amendment, by us and TeleTech, or in the case of a waiver, by the party against whom the waiver is to be effective. No failure or delay by any party in exercising any right, power or privilege under the Acquisition Agreement shall operate as a waiver thereof.

## **Terms of Other Agreements**

### ***Terms of the Voting Agreements***

In connection with the Acquisition Agreement, the Company's directors, executive officers and certain stockholders, who, as of the Record Date, collectively had voting power over approximately 48.5% of the issued and outstanding shares of eLoyalty Stock, entered into voting agreements with TeleTech. Under the terms of the voting agreements, each stockholder has irrevocably appointed TeleTech's secretary as proxy for such stockholder to vote his, her, or its shares, including any shares acquired after the date of the agreement, (i) for the Proposal to Sell the ICS Business, the Name Change Charter Amendment, and the other transactions contemplated by, and in each case pursuant to, the terms of the Acquisition Agreement, and (ii) against any proposal regarding any Acquisition Proposal (as defined above). The proxy automatically terminates upon termination of the Acquisition Agreement or upon any material amendment or modification of the Acquisition Agreement that adversely affects the consideration payable to us.

Under the terms of the voting agreement that TeleTech entered into with our directors and executive officers, SHV and certain affiliates of SHV (the Insider Stockholders), who, as of the Record Date, collectively had voting power over approximately 33% of the issued and outstanding shares of eLoyalty Stock, the Insider Stockholders have also agreed that, subject to certain exceptions, they will not transfer any shares prior to the closing date of the proposed sale. The voting agreements that TeleTech entered into with RKB Capital, LP, Peter D. Schleider, Peninsula Master Fund, Ltd. and Alydar Partners, LLC (the Non-Insider Stockholders), who, as of the Record Date, collectively had voting power over approximately 15% of the issued and outstanding shares of eLoyalty Stock, provide that, subject to certain exceptions, the Non-Insider Stockholders will not transfer any shares for at least ten business days following the date of the agreements.

The forms of the voting agreements entered into with the Insider Stockholders and the Non-Insider Stockholders are attached to this proxy statement as *Annex B*. The foregoing summary of the voting agreements does not purport to be complete, and all stockholders are urged to read the form voting agreements attached hereto as *Annex B* in their entirety.

### ***Terms of the Escrow Agreement***

Pursuant to the terms of the Acquisition Agreement, \$1.5 million of the total purchase price will be funded into an escrow account to satisfy our obligations under any indemnification claims that may be made by TeleTech. In connection with the Acquisition Agreement, we and TeleTech will enter into an escrow agreement with an escrow agent effective upon the closing of the sale of the ICS Business, pursuant to which the escrow agent will hold \$1,500,000 until the six month anniversary of the closing, subject to any claims that may be made by TeleTech.

## **Recommendation of Our Board of Directors**

**THE BOARD OF DIRECTORS RECOMMENDS THAT STOCKHOLDERS VOTE FOR**

**PROPOSAL #1, THE PROPOSAL TO SELL THE ICS BUSINESS.**

**eLOYALTY CORPORATION**

**SELECTED UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL DATA**

The following unaudited pro forma consolidated financial information sets forth the pro forma consolidated results of operations of the Company for fiscal years ended 2010, 2009, and 2008, which ended January 1, 2011, December 26, 2009, and December 27, 2008, respectively, and the pro forma balance sheets of the Company as of January 1, 2011 and December 26, 2009.

The unaudited pro forma consolidated statements of operations have been derived from the Company's historical consolidated financial information and give effect to the proposed sale of all of the assets and assumption of certain liabilities of the Company's ICS Business, in exchange for approximately \$40.85 million in cash, subject to adjustment, as if such sale had occurred on the first day of fiscal years 2010, 2009, and 2008, which began on December 27, 2009, December 28, 2008, and December 30, 2007, respectively. In addition, the unaudited pro forma consolidated balance sheets have been derived from the Company's historical consolidated financial information and give effect to the proposed sale of the ICS Business as if it had occurred on each of the balance sheet dates.

The unaudited pro forma consolidated statements of operations are based on the assumptions and adjustments described in the accompanying notes and do not reflect any adjustments for non-recurring items or changes in operating strategies arising as a result of the transaction. These unaudited pro forma consolidated financial statements include no assumptions regarding the use of proceeds (other than to pay transaction related expenses), which are presented as additional cash on the unaudited pro forma consolidated balance sheets. Accordingly, the actual effect of the transaction, due to this and other factors, could differ from the pro forma adjustments presented herein. However, management believes that the assumptions used and the adjustments made are reasonable under the circumstances and given the information available.

The unaudited pro forma consolidated financial statements are presented for illustrative purposes only and are not necessarily indicative of the operating results or the financial position that would have been achieved had the transaction been consummated as of the dates indicated or of the results that may be obtained in the future. These unaudited pro forma consolidated financial statements and the accompanying notes should be read together with the Company's Annual Report on Form 10-K for the year ended January 1, 2011 filed with the Securities Exchange Commission on March 17, 2011. The historical financial information included in Company's Annual Report on Form 10-K is also attached hereto as Annex D.

## eLOYALTY CORPORATION

## UNAUDITED PRO FORMA CONSOLIDATED BALANCE SHEETS

JANUARY 1, 2011

(In thousands, except share and per share data)

	Historical eLoyalty	Pro Forma Adjustment	Pro Forma eLoyalty
<b>ASSETS:</b>			
Current Assets:			
Cash and cash equivalents	\$ 20,872	\$ 30,049a	\$ 50,921
Restricted cash	2,460		2,460
Receivables, net	8,613	(6,572)b	2,041
Prepaid expenses	13,746	(9,443)b	4,303
Other current assets	892	(596)b	296
Total current assets	46,583	13,438	60,021
Equipment and leasehold improvements, net	5,867	(1,470)b	4,397
Goodwill	2,643	(1,671)b	972
Intangibles, net	428	(76)b	352
Other long-term assets	10,671	(7,090)b	3,581
Total assets	\$ 66,192	\$ 3,131	\$ 69,323
<b>LIABILITIES AND STOCKHOLDERS (DEFICIT) EQUITY:</b>			
Current Liabilities:			
Accounts payable	\$ 2,498	\$ (2,134)b	\$ 364
Accrued compensation and related costs	3,033	(986)b	2,047
Unearned revenue	24,212	(16,327)b	7,885
Other current liabilities	4,983	(721)b	4,262
Total current liabilities	34,726	(20,168)	14,558
Long-term unearned revenue	15,928	(11,243)b	4,685
Other long-term liabilities	1,592	(30)b	1,562
Total liabilities	52,246	(31,441)	20,805
Series B Stock, \$0.01 par value; 5,000,000 shares authorized and designated; 3,549,078 shares issued and outstanding at January 1, 2011, with a liquidation preference of \$19,367 at January 1, 2011			
	18,100		18,100
Stockholders (Deficit) Equity:			
Preferred stock, \$0.01 par value; 35,000,000 shares authorized; none issued and outstanding			
Common stock, \$0.01 par value; 50,000,000 shares authorized; 15,642,822 shares issued at January 1, 2011; and 14,786,005 outstanding at January 1, 2011			
	156		156
Additional paid-in capital	207,985		207,985
Accumulated deficit	(204,139)	34,572c	(169,567)
Treasury stock, at cost, 856,817 shares at January 1, 2011	(4,468)		(4,468)
Accumulated other comprehensive loss	(3,688)		(3,688)
Total stockholders (deficit) equity	(4,154)	34,572	30,418
Total liabilities and stockholders (deficit) equity	\$ 66,192	\$ 3,131	\$ 69,323

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See accompanying notes to unaudited pro forma consolidated financial statements.

## eLOYALTY CORPORATION

## UNAUDITED PRO FORMA CONSOLIDATED BALANCE SHEETS

DECEMBER 26, 2009

(In thousands, except share and per share data)

	Historical eLoyalty	Pro Forma Adjustment	Pro Forma eLoyalty
<b>ASSETS:</b>			
Current Assets:			
Cash and cash equivalents	\$ 28,982	\$ 31,818a	\$ 60,800
Restricted cash	3,745		3,745
Receivables, net	9,313	(5,874)b	3,439
Prepaid expenses	10,126	(4,982)b	5,144
Other current assets	944	(673)b	271
Total current assets	53,110	20,289	73,399
Equipment and leasehold improvements, net	6,194	(729)b	5,465
Goodwill	2,643	(1,671)b	972
Intangibles, net	476		476
Other long-term assets	8,180	(4,313)b	3,867
Total assets	\$ 70,603	\$ 13,576	\$ 84,179
<b>LIABILITIES AND STOCKHOLDERS EQUITY:</b>			
Current Liabilities:			
Accounts payable	\$ 3,634	\$ (2,686)b	\$ 948
Accrued compensation and related costs	5,762	(2,406)b	3,356
Unearned revenue	20,436	(10,026)b	10,410
Other current liabilities	5,067	(669)b	4,398
Total current liabilities	34,899	(15,787)	19,112
Long-term unearned revenue	9,526	(5,725)b	3,801
Other long-term liabilities	1,705	(138)b	1,567
Total liabilities	46,130	(21,650)	24,480
Series B Stock, \$0.01 par value; 5,000,000 shares authorized and designated; 3,616,169 shares issued and outstanding at December 26, 2009, with a liquidation preference of \$19,733 at December 26, 2009			
	18,442		18,442
Stockholders (Deficit) Equity:			
Preferred stock, \$0.01 par value; 35,000,000 shares authorized; none issued and outstanding			
Common stock, \$0.01 par value; 50,000,000 shares authorized; 14,871,521 shares issued at December 26, 2009; and 14,220,279 outstanding at December 26, 2009			
	149		149
Additional paid-in capital	203,627		203,627
Accumulated deficit	(190,821)	35,226c	(155,595)
Treasury stock, at cost, 651,242 shares at December 26, 2009	(3,295)		(3,295)
Accumulated other comprehensive loss	(3,629)		(3,629)
Total stockholders equity	6,031	35,226	41,257
Total liabilities and stockholders equity	\$ 70,603	\$ 13,576	\$ 84,179

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See accompanying notes to unaudited pro forma consolidated financial statements.



## eLOYALTY CORPORATION

## UNAUDITED PRO FORMA CONSOLIDATED STATEMENT OF OPERATIONS

FOR THE FISCAL YEAR ENDED JANUARY 1, 2011

(In thousands, except per share data)

	Historical eLoyalty	Pro Forma Adjustment <sup>(d)</sup>	Pro Forma eLoyalty
<b>Revenue:</b>			
Services	\$ 71,808	\$ (41,548)	\$ 30,260e
Product	12,581	(12,581)	
Revenue before reimbursed expenses (net revenue)	84,389	(54,129)	30,260
Reimbursed expenses	3,715	(3,090)	625
Total revenue	88,104	(57,219)	30,885
<b>Operating expenses:</b>			
Cost of services	43,326	(27,936)	15,390
Cost of product	10,360	(10,360)	
Cost of revenue before reimbursed expenses	53,686	(38,296)	15,390
Reimbursed expenses	3,715	(3,090)	625
Total cost of revenue, exclusive of depreciation and amortization shown below:	57,401	(41,386)	16,015
Selling, general and administrative	38,273	(9,366)	28,907
Severance and related costs	1,180	(686)	494
Depreciation	4,074	(784)	3,290
Amortization of intangibles	144	(4)	140
Total operating expenses	101,072	(52,226)	48,846
Operating loss	(12,968)	(4,993)	(17,961)
Interest and other (expense), net	(121)		(121)
Loss from continuing operations before income taxes	(13,089)	(4,993)	(18,082)
Income tax provision	(93)		(93)
Loss from continuing operations	(13,182)	(4,993)	(18,175)
Loss on discontinued operations	(136)		(136)
Net loss	(13,318)	(4,993)	(18,311)
Dividends related to Series B Stock	(1,273)		(1,273)
Net loss available to common stockholders	\$ (14,591)	\$ (4,993)	\$ (19,584)
<b>Per common share:</b>			
Basic loss from continuing operations	\$ (0.96)	\$	\$ (1.33)
Basic loss from discontinued operations	\$ (0.01)	\$	\$ (0.01)
Basic net loss available to common stockholders	\$ (1.06)	\$	\$ (1.43)

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Diluted loss from continuing operations	\$ (0.96)	\$	\$ (1.33)
Diluted loss from discontinued operations	\$ (0.01)	\$	\$ (0.01)
Diluted net loss available to common stockholders	\$ (1.06)	\$	\$ (1.43)
Shares used to calculate basic net loss per share	13.70		13.70
Shares used to calculate diluted net loss per share	13.70		13.70

Stock-based compensation, primarily restricted stock, is included in individual line items above:

Cost of services	\$ 99	\$ (31)	\$ 68
Selling, general and administrative	5,102	(786)	4,316
Severance and related costs	76	(57)	19

See accompanying notes to unaudited pro forma consolidated financial statements.

## eLOYALTY CORPORATION

## UNAUDITED PRO FORMA CONSOLIDATED STATEMENT OF OPERATIONS

FOR THE FISCAL YEAR ENDED DECEMBER 26, 2009

(In thousands, except per share data)

	Historical eLoyalty	Pro Forma Adjustment <sup>(d)</sup>	Pro Forma eLoyalty
Revenue:			
Services	\$ 79,862	\$ (48,037)	\$ 31,825e
Product	17,780	(17,780)	
Revenue before reimbursed expenses (net revenue)	97,642	(65,817)	31,825
Reimbursed expenses	3,971	(3,233)	738
Total revenue	101,613	(69,050)	32,563
Operating expenses:			
Cost of services	52,442	(32,595)	19,847
Cost of product	14,814	(14,814)	
Cost of revenue before reimbursed expenses	67,256	(47,409)	19,847
Reimbursed expenses	3,971	(3,233)	738
Total cost of revenue, exclusive of depreciation and amortization shown below:	71,227	(50,642)	20,585
Selling, general and administrative	35,163	(10,427)	24,736
Severance and related costs	1,341	(371)	970
Depreciation	4,242	(490)	3,752
Amortization of intangibles	223		223
Total operating expenses	112,196	(61,930)	50,226
Operating loss	(10,583)	(7,120)	(17,703)
Interest and other income, net	53		53
Loss from continuing operations before income taxes	(10,530)	(7,120)	(17,650)
Income tax provision	(44)		(44)
Loss from continuing operations	(10,574)	(7,120)	(17,694)
Loss on discontinued operations	(46)		(46)
Net loss	(10,620)	(7,120)	(17,740)
Dividends related to Series B Stock	(1,292)		(1,292)
Net loss available to common stockholders	\$ (11,912)	\$ (7,120)	\$ (19,032)
Per common share:			
Basic loss from continuing operations	\$ (0.80)	\$	\$ (1.33)
Basic loss from discontinued operations	\$	\$	\$
Basic net loss available to common stockholders	\$ (0.90)	\$	\$ (1.44)

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Diluted loss from continuing operations	\$ (0.80)	\$	\$ (1.33)
Diluted loss from discontinued operations	\$	\$	\$
Diluted net loss available to common stockholders	\$ (0.90)	\$	\$ (1.44)
Basic weighted average shares outstanding	13.26		13.26
Diluted weighted average shares outstanding	13.26		13.26

Stock-based compensation, primarily restricted stock, is included in individual line items above:

Cost of services	\$ 504	\$ (270)	\$ 234
Selling, general and administrative	5,793	(1,254)	4,539
Severance and related costs	248		248

See accompanying notes to unaudited pro forma consolidated financial statements.

## eLOYALTY CORPORATION

## UNAUDITED PRO FORMA CONSOLIDATED STATEMENT OF OPERATIONS

FOR THE FISCAL YEAR ENDED DECEMBER 27, 2008

(In thousands, except per share data)

	Historical eLoyalty	Pro Forma Adjustment <sup>(d)</sup>	Pro Forma eLoyalty
Revenue:			
Services	\$ 77,796	\$ (41,612)	\$ 36,184e
Product	9,777	(9,777)	
Revenue before reimbursed expenses (net revenue)	87,573	(51,389)	36,184
Reimbursed expenses	3,624	(2,325)	1,299
Total revenue	91,197	(53,714)	37,483
Operating expenses:			
Cost of services	53,586	(28,690)	24,896
Cost of product	7,945	(7,945)	
Cost of revenue before reimbursed expenses	61,531	(36,635)	24,896
Reimbursed expenses	3,624	(2,325)	1,299
Total cost of revenue, exclusive of depreciation and amortization shown below:	65,155	(38,960)	26,195
Selling, general and administrative	41,182	(11,395)	29,787
Severance and related costs	1,635	(52)	1,583
Depreciation	3,845	(507)	3,338
Amortization of intangibles	340		340
Total operating expenses	112,157	(50,914)	61,243
Operating loss	(20,960)	(2,800)	(23,760)
Interest and other income, net	70		70
Loss from continuing operations before income taxes	(20,890)	(2,800)	(23,690)
Income tax provision	(15)		(15)
Loss from continuing operations	(20,905)	(2,800)	(23,705)
Loss on discontinued operations	(748)		(748)
Net loss	(21,653)	(2,800)	(24,453)
Dividends related to Series B Stock	(1,296)		(1,296)
Net loss available to common stockholders	\$ (22,949)	\$ (2,800)	\$ (25,749)
Per common share:			
Basic loss from continuing operations	\$ (2.02)	\$	\$ (2.29)
Basic loss from discontinued operations	\$ (0.07)	\$	\$ (0.07)
Basic net loss available to common stockholders	\$ (2.21)	\$	\$ (2.48)
Diluted loss from continuing operations	\$ (2.02)	\$	\$ (2.29)

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Diluted loss from discontinued operations	\$ (0.07)	\$	\$ (0.07)
Diluted net loss available to common stockholders	\$ (2.21)	\$	\$ (2.48)
Basic weighted average shares outstanding	10.37		10.37
Diluted weighted average shares outstanding	10.37		10.37

Stock-based compensation, primarily restricted stock, is included in individual line items above:

Cost of services	\$ 3,345	\$ (1,472)	\$ 1,873
Selling, general and administrative	11,335	(3,413)	7,922
Severance and related costs	103		103

See accompanying notes to unaudited pro forma consolidated financial statements.

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**eLOYALTY CORPORATION**

**NOTES TO UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL STATEMENTS**

**Basis of Presentation**

The unaudited pro forma consolidated financial information gives effect to the proposed sale of all of the assets and the assumption of certain liabilities of the Company's ICS Business by TeleTech in exchange for \$40.85 million in cash, subject to adjustment as set forth in the Acquisition Agreement. The Company expects to account for the disposition as a discontinued operation in its consolidated financial statements in accordance with the Accounting Standards Codification (ASC) 205-20, *Accounting for the Impairment or Disposal of Long Lived Assets*, if stockholder approval of the transaction is obtained.

During the periods presented, the ICS Business operated as an operating segment within the Company. As such, the Company did not maintain separate, stand-alone financial statements for the ICS Business. Accordingly, the financial information of the ICS Business has been prepared from the Company's historical accounting records and does not purport to reflect a balance sheet and statement of operations that would have resulted if the ICS Business had been a separate, stand-alone company.

The unaudited pro forma consolidated statements of operations for the years ended January 1, 2011, December 26, 2009, and December 27, 2008 have been derived from the Company's historical consolidated financial information and give effect to the proposed sale as if it had occurred on December 27, 2009, December 28, 2008, and December 30, 2007, respectively. In addition, the unaudited pro forma consolidated balance sheets as of January 1, 2011 and December 26, 2009 have been derived from the Company's historical consolidated financial information and give effect to the proposed sale of the ICS Business as if it had occurred on each of the balance sheet dates.

The unaudited pro forma consolidated statements of operations are based on the assumptions and adjustments described in the accompanying notes and do not reflect any adjustments for non-recurring items or changes in operating strategies arising as a result of the transaction. These unaudited pro forma consolidated financial statements include no assumptions regarding the use of proceeds (other than to pay transaction related expenses), which are presented as additional cash on the unaudited pro forma consolidated balance sheets. Accordingly, the actual effect of the transaction, due to this and other factors, could differ from the pro forma adjustments presented herein. However, management believes that the assumptions used and the adjustments made are reasonable under the circumstances and given the information available.

These unaudited pro forma consolidated financial statements are presented for illustrative purposes only and are not necessarily indicative of the operating results or the financial position that would have been achieved had the transaction been consummated as of the dates indicated or of the results that may be obtained in the future. These unaudited pro forma consolidated financial statements and the accompanying notes should be read together with the Company's Annual Report on Form 10-K for the year ended January 1, 2011 filed with the Securities and Exchange Commission on March 17, 2011. The historical financial information included in Company's Annual Report on Form 10-K is also attached hereto as Annex D.

## eLOYALTY CORPORATION

## NOTES TO UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL STATEMENTS

## Pro Forma Adjustments

Pro forma adjustments reflect those adjustments which are directly attributable to the transaction and include the following (amounts in thousands):

- a) Represents the purchase price of \$40,850 less estimated direct transaction costs of \$1,945. Also reflects the adjustment to proceeds for Managed Services and Working Capital Adjustments defined in Acquisition Agreement. The Managed Services adjustment reflects the net difference between total unearned revenue and associated prepaid/deferred costs. Managed Services adjustments of (\$11,728) and (\$6,970) were included in Cash and Cash equivalents in fiscal years 2010 and 2009, respectively. The Managed Services adjustments are based upon the net difference between total unearned revenue and associated prepaid/deferred costs as of each balance sheet date. The actual Managed Services adjustment will be determined as of the closing date and, therefore, may differ materially from the amounts presented. The Working Capital adjustment reflects the adjustment (up or down) that will be made to the proceeds based on the difference between (i) the ratio between current assets, excluding current prepaid/deferred costs, and current liabilities, excluding current unearned revenue, as of the closing date and (ii) 1.21. Working Capital adjustments of \$2,872 and (\$117) were included in Cash and Cash equivalents in fiscal years 2010 and 2009, respectively.
- b) Eliminates the assets to be acquired and liabilities to be assumed by TeleTech in connection with the disposition of the ICS Business.
- c) Represents the estimated gain on sale of net assets before federal, state, and foreign taxes.
- d) Eliminates the financial results of operations of the ICS Business, as adjusted for removal of revenue and direct costs of traditional CRM Consulting Services, includes facility costs associated with the office in Austin, Texas, which is primarily used by the ICS Business, and includes corporate and administrative costs that have been attributed to the ICS Business.

## Pro Forma Services Revenue

- e) Pro Forma services revenue, after the sale of the ICS Business, includes consulting services and subscription services from our Behavioral Analytics Service, as well as legacy revenue. Legacy revenue consists of (i) traditional CRM consulting services, which historically has been included in our ICS business segment, and (ii) marketing managed services, which historically has been included in our Behavioral Analytics Service business segment. Pro Forma services revenues are broken down as follows:

	For the Fiscal Years Ended		
	2010	2009	2008
Behavioral Analytics Consulting Services revenue	\$ 584	\$ 711	\$ 1,498
Behavioral Analytics Subscription Services revenue	24,147	18,406	11,614
Legacy revenue	5,529	12,708	23,072
Total	\$ 30,260	\$ 31,825	\$ 36,184



**UNAUDITED FINANCIAL STATEMENTS OF THE INTEGRATED CONTACT SOLUTIONS BUSINESS UNIT OF eLOYALTY CORPORATION**

The following unaudited financial statements, for fiscal years 2010, 2009, and 2008, which ended January 1, 2011, December 26, 2009, and December 27, 2008, respectively, were prepared to present, pursuant to the Acquisition Agreement, the assets to be acquired, the liabilities to be assumed, and the related revenues and direct expenses of the ICS Business.

The accompanying unaudited financial statements of the ICS Business exclude certain liabilities of the ICS Business (as not all liabilities are to be assumed) and exclude traditional CRM consulting revenue and direct expenses previously included in the Company's segment reporting for the ICS Business. In addition, allocated facility costs associated with our office in Austin, Texas, which is primarily utilized by the ICS Business, and corporate and administrative costs that have been attributed to the ICS Business, are included in these unaudited financial statements.

The accompanying financial statements have been prepared from the Company's historical accounting records and do not purport to reflect the revenues and direct expenses that would have resulted if the ICS Business had been a separate, stand-alone business during the periods presented. It is not practicable for management to reasonably estimate expenses that would have resulted if the ICS Business had operated as an unaffiliated, independent business. Since only certain assets are to be acquired and certain liabilities are to be assumed, a balance sheet and statement of stockholders' equity are not applicable.

As an operating segment of eLoyalty, the ICS Business is dependent upon eLoyalty for all of its working capital and financing requirements.

The unaudited financial statements of the ICS Business should be read in conjunction with our audited consolidated financial statements, including notes thereto, in our Annual Report filed on Form 10-K for the year ended January 1, 2011.

**INTEGRATED CONTACT SOLUTIONS BUSINESS UNIT OF eLOYALTY CORPORATION UNAUDITED STATEMENTS OF ASSETS AND LIABILITIES**

**AS OF JANUARY 1, 2011 AND DECEMBER 26, 2009**

(In thousands)

	January 1, 2011	December 26, 2009
<b>ASSETS</b>		
Receivables, net	\$ 6,572	\$ 5,874
Prepaid expenses	9,443	4,982
Other current assets	596	673
Equipment and leasehold improvements, net	1,470	729
Goodwill	1,671	1,671
Intangibles, net	76	
Other long-term assets	7,090	4,313
<b>Total assets</b>	<b>\$ 26,918</b>	<b>\$ 18,242</b>
<b>LIABILITIES</b>		
Accounts payable	\$ 2,134	\$ 2,686
Accrued compensation and related costs	986	2,406
Unearned revenue	16,327	10,026
Other current liabilities	721	669
Long-term unearned revenue	11,243	5,725
Other long-term liabilities	30	138
<b>Total Liabilities</b>	<b>31,441</b>	<b>21,650</b>
<b>NET LIABILITIES</b>	<b>\$ 4,523</b>	<b>\$ 3,408</b>

**INTEGRATED CONTACT SOLUTIONS BUSINESS UNIT OF eLOYALTY CORPORATION UNAUDITED CONSOLIDATED  
STATEMENT OF OPERATIONS**

(In thousands)

	For the Fiscal Years Ended		
	2010	2009	2008
<b>Revenue:</b>			
Services	\$ 41,548	\$ 48,037	\$ 41,612
Product	12,581	17,780	9,777
Revenue before reimbursed expenses (net revenue)	54,129	65,817	51,389
Reimbursed expenses	3,090	3,233	2,325
Total revenue	57,219	69,050	53,714
<b>Direct expenses:</b>			
Cost of services	27,936	32,595	28,690
Cost of product	10,360	14,814	7,945
Reimbursed expenses	3,090	3,233	2,325
Selling, general and administrative	9,366	10,427	11,395
Severance and related costs	686	371	52
Depreciation	784	490	507
Amortization of intangibles	4		
Total direct expenses	52,226	61,930	50,914
<b>Excess of revenues over direct expenses</b>	<b>\$ 4,993</b>	<b>\$ 7,120</b>	<b>\$ 2,800</b>

**INTEGRATED CONTACT SOLUTIONS BUSINESS UNIT OF eLOYALTY CORPORATION UNAUDITED CONSOLIDATED  
STATEMENTS OF CASH FLOWS**

(In thousands)

	For the Fiscal Years Ended		
	2010	2009	2008
<b>Cash Flows from Operating Activities:</b>			
Net income	\$ 4,993	\$ 7,120	\$ 2,800
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:			
Depreciation and amortization	788	490	507
Stock-based compensation	817	1,524	4,885
(Reversal) provision for uncollectible amounts	(60)	47	27
Severance and related cost	57		
Changes in assets and liabilities:			
Receivables	(668)	89	(1,169)
Prepaid expenses	(7,267)	(3,947)	2,269
Other assets	73	191	(433)
Accounts payable	(553)	(200)	822
Accrued compensation and related costs	(1,417)	600	150
Unearned revenue	11,841	6,253	(4,147)
Other liabilities	40	(386)	(11)
<b>Net cash provided by operating activities</b>	<b>8,644</b>	<b>11,781</b>	<b>5,700</b>
<b>Cash Flows from Investing Activities:</b>			
Capital expenditures and other	(1,593)	(415)	(78)
<b>Net cash used in investing activities</b>	<b>(1,593)</b>	<b>(415)</b>	<b>(78)</b>
<b>Cash Flows from Financing Activities:</b>			
Principal payments under capital lease obligations	(110)	(85)	(3)
Net distributions to eLoyalty Corporation	(6,967)	(11,300)	(5,583)
<b>Net cash used in financing activities</b>	<b>(7,077)</b>	<b>(11,385)</b>	<b>(5,586)</b>
Effect of exchange rate changes on cash and cash equivalents	26	19	(36)
<b>Increase in cash and cash equivalents</b>			
Cash and cash equivalents, beginning of period			
Cash and cash equivalents, end of period	\$	\$	\$
<b>Non-Cash Investing and Financing Transactions:</b>			
Capital lease obligations incurred	\$ 13	\$ 107	\$ 216
Capital equipment purchased on credit	13	107	216

See accompanying notes to consolidated financial statements.

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**INTEGRATED CONTACT SOLUTIONS BUSINESS UNIT OF eLOYALTY CORPORATION NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Dollars in millions, except share and per share data)**

**Note One Description of Business**

The ICS Business is engaged in the business of monitoring and supporting contact centers and related business applications, providing consulting and system integration services related to Cisco Voice over Internet Protocol solutions (including related hardware and software product resales), and providing operational consulting services to enhance customer services business performance through improved process efficiencies, redesign of call flows, and improved contact center operations.

**Note Two Summary of Significant Accounting Policies**

***Fiscal Year-End***

The fiscal year-end dates presented for fiscal years 2010, 2009, and 2008 are January 1, 2011, December 26, 2009, and December 27, 2008, respectively. Fiscal year 2010 consisted of fifty-three weeks instead of fifty-two weeks, which did not have a material impact on the ICS Business's financial position or results of operations.

***Basis of presentation***

The accompanying unaudited financial statements, for the fiscal years ended January 1, 2011, December 26, 2009, and December 27, 2008, were prepared to present, pursuant to the Acquisition Agreement, the assets to be acquired, the liabilities to be assumed, and the related revenues and direct expenses of the ICS Business.

The accompanying unaudited financial statements of the ICS Business exclude certain liabilities of the ICS Business (as not all liabilities are to be assumed) and exclude traditional CRM consulting revenue and direct expenses previously included in the Company's segment reporting for the ICS Business. In addition, allocated facility costs associated with our office in Austin, Texas, which is primarily utilized by the ICS Business, and corporate and administrative costs that have been attributed to the ICS Business, are included in these unaudited financial statements.

The accompanying financial statements have been prepared from the Company's historical accounting and do not purport to reflect the revenues and direct expenses that would have resulted if the ICS Business had been a separate, stand-alone business during the periods presented. It is not practicable for management to reasonably estimate expenses that would have resulted if the ICS Business had operated as an unaffiliated, independent business. Since only certain assets are to be acquired and certain liabilities are to be assumed, a balance sheet and statement of stockholders' equity are not applicable.

As an operating segment of eLoyalty, the ICS Business is dependent upon eLoyalty for all of its working capital and financing requirements.

***Use of Estimates***

The preparation of these financial statements requires management to make estimates and assumptions that affect the amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those amounts.

## ***Revenue Recognition***

### ***Integrated Contact Solutions Business Unit***

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

For fixed fee Managed services contracts, where the ICS Business provides support for third-party software and hardware, revenue is recorded at the gross amount of the sale. If the contract does not meet the requirements for gross reporting, then Managed services revenue is recorded at the net amount of the sale.

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

Revenue from the sale of Product, which is generated from the resale of third-party software and hardware by the ICS Business, is generally recorded at the gross amount of the sale.

Within the Integrated Contact Solutions Service Line, Consulting services, Managed services, and the resale of Product may be sold and delivered together. In arrangements that include the resale of software, vendor-specific objective evidence ( VSOE ) must be determined for each of the individual elements. If VSOE does not exist for the allocation of revenue to the various elements of the arrangement, then all revenue from the arrangement is deferred until all elements of the arrangement without VSOE have been delivered to the client. Upon the delivery of the element without VSOE, revenue is allocated to this element based on the total value of the arrangement less the VSOE amounts established for the other elements. If the remaining undelivered elements are post-contract support ( PCS ) or other deliverables with similar attribution periods, then the arrangement revenue is recognized ratably over the remaining service period.

Multiple-element arrangements are segmented into separate earning processes when the elements have objective and reliable evidence of fair value and have value to the customer on a stand-alone basis. Revenue related to contracts with multiple elements is allocated based on the fair value of the element and is recognized in accordance with the ICS Business's revenue recognition policy for each type of element, as described above. If the fair value for any undelivered element cannot be established, then revenue is deferred until all elements have been delivered to the client. If PCS or similar services are the only remaining activity without established fair value, then the revenue for the entire arrangement is recognized ratably over the service period.

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

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

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

Cost of services primarily consists of labor costs including salaries, fringe benefits, and incentive compensation of the ICS Business delivery personnel and Selling, general and administrative personnel working

on direct, revenue-generating activities and third-party pass-through costs related to the Company's Managed services. Cost of services also includes employee costs for travel expenses, training, laptop computer leases, and other expenses of a non-billable nature. Cost of services excludes depreciation and amortization.

#### ***Selling, General and Administrative***

Selling, general and administrative expenses consist primarily of salaries, incentive compensation, commissions, and employee benefits for business development, account management, solution development/support, marketing and administrative costs of the ICS Business. Corporate administrative costs directly attributable to the ICS Business, as well as allocated facility costs associated with the Austin location, primarily used by the ICS Business, are also included in these costs. The personnel costs included here are net of any labor costs directly related to the generation of revenue, which are represented in Cost of services.

The selling, general and administrative expenses are not necessarily indicative of the expenses that would have been incurred had the ICS Business operated as a separate stand-alone business during the periods presented. It is not practical for management to reasonably estimate the expenses that would have been incurred by the ICS Business had it operated as a separate stand alone business.

#### ***Unearned Revenue***

Current unearned revenue was \$16.3 million and \$10.0 million as of January 1, 2011 and December 26, 2009, respectively. Current unearned revenue reflects prepayment by the ICS Business's clients in advance of the ICS Business's recognition of this revenue. Payments are generally received in advance from clients that are utilizing the ICS Business's Managed services. Current unearned revenue will be recognized within the next 12 months.

Long-term unearned revenue was \$11.2 million and \$5.7 million as of January 1, 2011 and December 26, 2009, respectively. Long-term unearned revenue reflects prepayment by the ICS Business's clients in advance of the ICS Business's recognition of this revenue. Payments are generally received in advance from clients that are utilizing the ICS Business's Managed services. Long-term unearned revenue reflects revenue that will be recognized beyond the next 12 months.

#### ***Equipment and Leasehold Improvements***

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

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

The ICS Business leases certain equipment using both capital leases and operating leases. Assets leased under capital leases are recorded at the present value of future lease payments and depreciated on a straight line basis. All capital leases are for terms of either 30 or 36 months.

Equipment and leasehold improvements consist of the following:

	January 1, 2011	As of December 26, 2009
Computers and software	\$ 4.9	\$ 5.1
Furniture and equipment	0.3	0.3
Leasehold improvements	0.2	0.2
Equipment and leasehold improvements, gross	5.4	5.6
Accumulated depreciation and amortization	(3.9)	(4.9)
Equipment and leasehold improvements, net	\$ 1.5	\$ 0.7

Depreciation expense was \$0.8 million, \$0.5 million, and \$0.5 million, for fiscal years 2010, 2009, and 2008, respectively. Assets acquired under capital leases were \$0.0 million, \$0.1 million, and \$0.2 million in fiscal years 2010, 2009, and 2008, respectively. Depreciation expense on capital lease assets was \$0.1 million, \$0.1 million, and \$0.0 million in fiscal years 2010, 2009, and 2008, respectively.

#### ***Goodwill***

Goodwill is tested annually for impairment using a two-step test approach. In the first step, the fair value of the reporting unit is compared with its carrying value. If the fair value exceeds the carrying value, then goodwill is not impaired and no further testing is performed. The second step is performed if the carrying value exceeds the fair value. The implied fair value of the reporting unit's goodwill must be determined and compared to the carrying value of the goodwill. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, then an impairment loss equal to the difference will be recorded.

There has been no impairment identified as a result of the annual review of goodwill as of January 1, 2011 and December 26, 2009. The carrying value of goodwill was \$1.7 million as of January 1, 2011 and December 26, 2009, respectively.

#### ***Intangible Assets***

Intangible assets reflect costs related to trademark applications. Trademark applications are amortized over 120 months. The original cost of intangible assets as of January 1, 2011 was \$0.1 million. The ICS Business did not have any intangible assets as of December 26, 2009. Accumulated amortization of intangible assets as of January 1, 2011 was four thousand dollars. No accumulated amortization of intangible assets existed at December 26, 2009. Amortization expense of intangible assets is currently anticipated to be eight thousand dollars in fiscal year 2011 and annually thereafter.

#### ***Stock-Based Compensation***

Stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the vesting period. Determining fair value of stock-based awards at the grant date requires certain assumptions. Stock-based compensation totaled \$0.9 million, \$1.5 million, and \$4.9 million for the years ended January 1, 2011, December 26, 2010, and December 27, 2008, respectively. The table below provides a breakdown of stock-based compensation between direct cost categories:

	For the Fiscal Year		
	2010	2009	2008
Stock-based compensation			
Cost of services	\$ 31	\$ 270	\$ 1,472
Selling, general and administrative	786	1,254	3,413
Severance and related costs	57		
Total	\$ 874	\$ 1,524	\$ 4,885





**Note Three Receivables, Net**

Receivables consist of the following:

	January 1, 2011	As of December 26, 2009
Amounts billed to clients	\$ 5.7	\$ 5.2
Unbilled revenue	1.0	0.8
	6.7	6.0
Allowances for doubtful accounts	(0.1)	(0.1)
Receivables, net	\$ 6.6	\$ 5.9

Amounts billed to clients represent fees and reimbursable project-related expenses. Unbilled revenue represents fees, project-related expenses, materials, and subcontractor costs performed in advance of billings in accordance with contract terms. Unbilled revenue at January 1, 2011 and December 26, 2009 consists of amounts due from clients and is anticipated to be collected within normal terms. The ICS Business maintains allowances for doubtful accounts for estimated losses resulting from the inability of its clients to make required payments and clients indicating their intention to dispute their obligation to pay for contractual services provided by us. If the financial condition of our clients were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

**Note Four Current Prepaid Expenses**

Current prepaid expenses were \$9.4 million and \$5.0 million as of January 1, 2011 and December 26, 2009, respectively. Current prepaid expenses primarily consist of third-party support costs related to our ICS Business's Managed services. These costs are recognized over the contract terms of the respective agreements, which are generally one to five years. Costs included in current prepaid expenses will be recognized within the next 12 months. Current prepaid expenses consisted of the following:

	January 1, 2011	As of December 26, 2009
Prepaid third-party support costs	\$ 9.0	\$ 4.7
Other	0.4	0.3
Total	\$ 9.4	\$ 5.0

**Note Five Other Long-Term Assets**

Other long-term assets were \$7.1 million and \$4.3 million as of January 1, 2011 and December 26, 2009, respectively. Other long-term assets primarily consist of third-party support costs related to managed services agreements. These costs are recognized over the terms of the respective agreements, which are generally one to five years. Costs included in long-term assets will be recognized over the remaining term of the agreements beyond the first 12 months. Other long-term assets consisted of the following:

	January 1, 2011	As of December 27, 2008
Prepaid third-party support costs	\$ 6.7	\$ 4.1
Other	0.4	0.2
Total	\$ 7.1	\$ 4.3



**Note Six Restructuring Charges**

Severance costs are comprised primarily of contractual salary and related fringe benefits over the severance payment period. During fiscal years 2010, 2009, and 2008, the ICS Business recognized pre-tax charges of \$0.7 million, \$0.4 million, and \$0.1 million, respectively. For fiscal year 2010, the ICS Business recorded \$0.7 million of expense related to severance and related costs for the elimination of 37 positions. The \$0.4 million of expense recorded in fiscal year 2009 was primarily due to the elimination of 15 positions, and \$0.1 million of expense recorded in fiscal year 2008 related to severance and related costs for the elimination of four positions.

During fiscal years 2010, 2009, and 2008, the ICS Business made cash payments of \$0.7 million, \$0.4 million, and \$0.1 million, respectively, related to cost-reduction actions, which were primarily severance and related costs. The ICS Business expects substantially all remaining severance payments to be paid out by the first quarter of 2011 pursuant to agreements entered into with affected employees.

The severance and related costs and their utilization for the fiscal years ended 2008, and 2009, and 2010 are as follows:

	<b>Employee Severance</b>	<b>Facilities</b>	<b>Total</b>
	\$	\$	\$
<b>Balance, December 29, 2007</b>			
Charges	0.1		0.1
Adjustments			
Charged to severance and related costs	0.1		0.1
Payments	(0.1)		(0.1)
<b>Balance, December 27, 2008</b>			
Charges	0.4		0.4
Adjustments			
Charged to severance and related costs	0.4		0.4
Payments	(0.4)		(0.4)
<b>Balance, December 26, 2009</b>			
Charges	0.7		0.7
Adjustments			
Charged to severance and related costs	0.7		0.7
Payments	(0.7)		(0.7)
<b>Balance, January 1, 2011</b>	\$	\$	\$

The \$22 thousand and \$8 thousand that remained reserved at January 1, 2011 and December 26, 2009, respectively, relate to severance and related costs and are in Accrued Compensation and Related Costs.

**Note Seven Leases****Capital Leases**

The ICS Business acquired \$0.0 million and \$0.1 million of computer equipment, software, and leasehold improvements using capital leases during fiscal years 2010 and 2009, respectively. There was \$0.1 million, \$0.1 million, and \$0.0 million of depreciation on capital leases during 2010, 2009, and 2008, respectively. All capital leases are for a term of either 30 or 36 months.



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The following is a schedule, by year, of future minimum lease payments under capital leases, together with the present value of the net minimum lease payments as of January 1, 2011:

Year	Amount
2011	\$ 0.1
2012	
2013	
Thereafter	
<b>Total minimum lease payments</b>	<b>\$ 0.1</b>
Less: estimated executory costs	
<b>Net minimum lease payments</b>	<b>\$ 0.1</b>
Less: amount representing interest	
<b>Present value of minimum lease payments</b>	<b>\$ 0.1</b>

	January 1, 2011	As of December 26, 2009
Computers and software	\$ 0.3	\$ 0.3
Accumulated depreciation and amortization	(0.2)	(0.1)
<b>Computers and software, net</b>	<b>\$ 0.1</b>	<b>\$ 0.2</b>

***Operating Leases***

The ICS Business leases property and computers under leases expiring at various dates through July 31, 2012. Rental expense for all operating leases approximated \$0.3 million, \$0.4 million, and \$0.4 million, for fiscal years ended 2010, 2009, and 2008, respectively.

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

Year	Amount
2011	\$ 0.2
2012	
2013	
2014	
2015	
Thereafter	

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