

SERVICESOURCE INTERNATIONAL, INC.

Form 10-Q

August 07, 2015

Table of Contents

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2015

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-35108

SERVICESOURCE INTERNATIONAL, INC.

(Exact name of registrant as specified in our charter)

Delaware

No. 81-0578975

(State or Other Jurisdiction of

(I.R.S. Employer

Incorporation or Organization)

Identification No.)

760 Market Street, 4th floor

94102

San Francisco, California

(Address of Principal Executive Offices)

(Zip Code)

(415) 901-6030

(Registrant's Telephone Number, Including Area Code)

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

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

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

Large accelerated filer  Accelerated filer

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

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

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

Class	Outstanding as of July 31, 2015
Common Stock	86,015,532



Table of Contents

SERVICESOURCE INTERNATIONAL, INC.  
Form 10-Q  
INDEX

	Page No.
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements (unaudited)</u>	<u>3</u>
<u>Condensed Consolidated Balance Sheets as of June 30, 2015 and December 31, 2014</u>	<u>3</u>
<u>Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2015 and 2014</u>	<u>4</u>
<u>Condensed Consolidated Statements of Comprehensive Loss for the three and six months ended June 30, 2015 and 2014</u>	<u>5</u>
<u>Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2015 and 2014</u>	<u>6</u>
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	<u>7</u>
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>19</u>
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>35</u>
<u>Item 4. Controls and Procedures</u>	<u>35</u>
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	<u>36</u>
<u>Item 1A. Risk Factors</u>	<u>36</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>54</u>
<u>Item 3. Defaults Upon Senior Securities</u>	<u>54</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>54</u>
<u>Item 5. Other Information</u>	<u>54</u>
<u>Item 6. Exhibits</u>	<u>54</u>
<u>Signatures</u>	<u>55</u>
<u>Exhibit Index</u>	<u>56</u>

Table of Contents

## PART I FINANCIAL INFORMATION

## Item 1. Financial Statements

SERVICESOURCE INTERNATIONAL, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

(Unaudited)

	June 30, 2015	December 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	\$78,045	\$90,382
Short-term investments	136,202	125,000
Accounts receivable, net	57,172	70,163
Deferred income taxes	390	398
Prepaid expenses and other	7,549	6,815
Total current assets	279,358	292,758
Property and equipment, net	25,540	25,658
Deferred income taxes, net of current portion	1,512	2,488
Goodwill and intangibles, net	10,201	10,957
Other assets, net	8,806	7,985
Total assets	\$325,417	\$339,846
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$1,210	\$2,922
Accrued taxes	1,101	1,721
Accrued compensation and benefits	18,957	20,056
Deferred revenue	7,311	7,018
Accrued expenses	6,383	8,882
Other current liabilities	2,282	2,569
Total current liabilities	37,244	43,168
Convertible notes, net	124,301	120,730
Other long-term liabilities	4,877	4,660
Total liabilities	166,422	168,558
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Common stock; \$0.0001 par value; 1,000,000 shares authorized; 85,687 shares issued and 85,566 shares outstanding as of June 30, 2015; 83,928 shares issued and 83,807 shares outstanding as of December 31, 2014	8	8
Treasury stock	(441	) (441
Additional paid-in capital	323,082	312,017
Accumulated deficit	(164,985	) (141,409
Accumulated other comprehensive income	1,331	1,113
Total stockholders' equity	158,995	171,288
Total liabilities and stockholders' equity	\$325,417	\$339,846

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.



Table of Contents

SERVICESOURCE INTERNATIONAL, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
 (In thousands, except per share amounts)  
 (Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
Net revenue	\$61,613	\$65,997	\$127,810	\$132,813
Cost of revenue	42,692	48,518	88,507	96,113
Gross profit	18,921	17,479	39,303	36,700
Operating expenses:				
Sales and marketing	10,165	17,212	21,000	32,883
Research and development	4,646	6,881	9,468	13,597
General and administrative	10,701	12,256	22,866	25,121
Restructuring and other	2,988	—	3,739	—
Total operating expenses	28,500	36,349	57,073	71,601
Loss from operations	(9,579 )	(18,870 )	(17,770 )	(34,901 )
Interest expense and other, net	(2,739 )	(2,196 )	(4,584 )	(4,770 )
Loss before income taxes	(12,318 )	(21,066 )	(22,354 )	(39,671 )
Income tax provision	1,089	26	1,223	161
Net loss	\$(13,407 )	\$(21,092 )	\$(23,577 )	\$(39,832 )
Net loss per share, basic and diluted	\$(0.16 )	\$(0.25 )	\$(0.28 )	\$(0.48 )
Weighted average common shares outstanding, basic and diluted	85,072	82,784	84,665	82,432

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Table of ContentsSERVICESOURCE INTERNATIONAL, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(In thousands)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
Net loss	\$(13,407	) \$(21,092	) \$(23,577	) \$(39,832
Other comprehensive loss, net of tax:				
Foreign currency translation adjustments	352	(105	) 105	334
Unrealized gain (loss) on short-term investments, net of tax	(261	) 120	113	99
Other comprehensive income, net of tax	91	15	218	433
Total comprehensive loss, net of tax	\$(13,316	) \$(21,077	) \$(23,359	) \$(39,399

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Table of Contents

SERVICESOURCE INTERNATIONAL, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (In thousands)  
 (Unaudited)

	Six Months Ended	
	June 30,	
	2015	2014
Cash flows from operating activities		
Net loss	\$(23,577	) \$(39,832
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	6,783	6,322
Amortization of debt discount and issuance costs	3,903	3,636
Accretion of premium on short-term investments and other	(497	) 40
Deferred income taxes	980	—
Stock-based compensation	7,544	10,932
Restructuring and other	3,450	—
Changes in operating assets and liabilities:		
Accounts receivable, net	11,754	15,504
Deferred revenue	338	(1,983
Prepaid expenses and other	(852	) (45
Accounts payable	(2,064	) 1,030
Accrued taxes	(555	) 315
Accrued compensation and benefits	(1,570	) 1,936
Accrued expenses	(2,448	) 2,499
Other liabilities	125	(446
Net cash provided by (used in) operating activities	3,314	(92
Cash flows from investing activities		
Acquisition of property and equipment	(5,114	) (5,577
Restricted cash	(1,244	) —
Cash paid for acquisition, net of cash acquired	—	(32,551
Purchases of short-term investments	(51,074	) (46,926
Sales of short-term investments	40,194	23,134
Maturities of short-term investments	290	3,943
Net cash used in investing activities	(16,948	) (57,977
Cash flows from financing activities		
Repayment on capital leases obligations	(91	) (212
Proceeds from common stock issuances	944	3,569
Net cash provided by financing activities	853	3,357
Net decrease in cash and cash equivalents	(12,781	) (54,712
Effect of exchange rate changes on cash and cash equivalents	444	156
Cash and cash equivalents at beginning of period	90,382	170,132
Cash and cash equivalents at end of period	\$78,045	\$115,576
The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.		



Table of Contents

SERVICESOURCE INTERNATIONAL, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 — Description of Business and Basis of Presentation

ServiceSource International, Inc. (together with its subsidiaries, the “Company”) is a global leader in recurring revenue management, partnering with technology and technology-enabled companies to optimize maintenance, support and subscription revenue streams, while also improving customer relationships and loyalty. The Company delivers these results via cloud-based solutions and dedicated service teams, leveraging benchmarks and best practices derived from its rich database of service and renewal behavior. By integrating software, managed services and data, the Company provides end-to-end management and optimization of the service-contract renewals process, including data management, quoting, selling and recurring revenue business intelligence. The Company receives commissions from its managed services customers based on renewal sales that the Company generates on their behalf under a pay-for-performance model, and subscription fee from customers of its cloud-based solutions. The Company’s corporate headquarters are located in San Francisco, California. The Company has offices in Colorado, Tennessee, Washington, the United Kingdom, Ireland, Malaysia, Singapore and Japan.

The accompanying unaudited interim condensed consolidated financial statements (“condensed consolidated financial statements”) include the accounts of ServiceSource International Inc. and its subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation.

These condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (“U.S. GAAP” or “GAAP”) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X, without audit. Accordingly, they do not include all of the information required by U.S. GAAP for annual financial statements. The unaudited condensed consolidated balance sheet as of December 31, 2014 has been derived from our audited annual consolidated financial statements included in our Annual Report on Form 10-K/A for the year ended December 31, 2014 filed with the SEC on March 17, 2015. These condensed consolidated financial statements and accompanying notes should be read in conjunction with our annual consolidated financial statements and the notes thereto for the year ended December 31, 2014, included in our Annual Report on Form 10-K/A.

In the opinion of management, these condensed consolidated financial statements reflect all adjustments, including normal recurring adjustments, management considers necessary for a fair statement of our financial position, operating results, and cash flows for the interim periods presented. Preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the Company’s condensed consolidated financial statements and accompanying notes. Actual results could differ materially from those estimates. Also, the results for the interim periods are not necessarily indicative of results for the entire year.

Amounts shown in the Accrued liabilities and other caption in the condensed consolidated balance sheet as of December 31, 2014 have been reclassified into Accrued expenses and Other current liabilities to reflect the current period presentation. Amounts shown in the Accrued liabilities and other caption in the condensed consolidated statement of cash flows for the six months ended June 30, 2014 have been reclassified into Accrued expenses and Other liabilities to reflect the current period presentation.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standard Board (“FASB”) issued Accounting Standard Update (“ASU”) No. 2014-09, Revenue from Contracts with Customers (Topic 606), which supersedes the revenue recognition requirements in the FASB’s Accounting Standards Codification (“ASC”) 605, Revenue Recognition. This ASU is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. In July 2015, the FASB approved a one year deferral of the effective

date to December 15, 2017, and early application would be permitted, but not before the original effective date of December 15, 2016, so the effective date will be the first quarter of fiscal year 2018 using one of two retrospective application methods. The Company has not determined the potential effects on the consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03, Simplifying the Presentation of Debt Issuance Cost, which requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The new guidance is effective for the Company beginning

Table of Contents

in the first quarter of fiscal year 2017, with early adoption permitted. The Company is currently evaluating the impact that adoption of ASU 2015-03 will have on its consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-05, Intangibles - Goodwill and Other - Internal-Use Software, which provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, the update specifies that the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. The update further specifies that the customer should account for a cloud computing arrangement as a service contract if the arrangement does not include a software license. ASU 2015-05 will be effective for the Company in fiscal year 2016. Early adoption is permitted. An entity can elect to adopt the amendments either (1) prospectively to all arrangements entered into or materially modified after the effective date or (2) retrospectively. The Company is currently evaluating the impact that adoption of ASU 2015-03 will have on its consolidated financial statements.

Note 2 — Cash, cash equivalents and short-term investments

Cash equivalents consist of highly liquid fixed-income investments with original maturities of three months or less at the time of purchase, including money market funds. The Company has cash and cash equivalents held on its behalf by a third party of \$0.3 million and \$0.9 million as of June 30, 2015 and December 31, 2014, respectively. Short-term investments consist of readily marketable securities with a remaining maturity of more than three months from time of purchase. The Company classifies all of its cash equivalents and short-term investments as “available for sale,” as these investments are free of trading restrictions. These marketable securities are carried at fair value, with the unrealized gains and losses, net of tax, reported as accumulated other comprehensive income and included as a separate component of stockholders’ equity. Gains and losses are recognized when realized. When the Company determines that an other-than-temporary decline in fair value has occurred, the amount of the decline that is related to a credit loss is recognized in earnings. Gains and losses are determined using the specific identification method. The Company’s realized gains and losses in the three and six months ended June 30, 2015 and 2014 were insignificant.

Cash and cash equivalents and short-term investments consisted of the following as of June 30, 2015 and December 31, 2014 (in thousands):

June 30, 2015

Description	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Cash	\$77,755	\$—	\$—	\$77,755
Cash equivalents:				
Money market mutual funds	290	—	—	290
Total cash and cash equivalents	78,045	—	—	78,045
Short-term investments:				
Corporate bonds	53,875	47	(103)	53,819
U.S. agency securities	46,806	131	(30)	46,907
Asset-backed securities	22,592	6	(27)	22,571
U.S. Treasury securities	12,871	38	(4)	12,905
Total short-term investments	136,144	222	(164)	136,202
Cash, cash equivalents and short-term investments	\$214,189	\$222	\$(164)	\$214,247
December 31, 2014				

Table of Contents

Description	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Cash	\$89,589	\$—	\$—	\$89,589
Cash equivalents:				
Money market mutual funds	793	—	—	793
Total cash and cash equivalents	90,382	—	—	90,382
Short-term investments:				
Corporate bonds	49,110	29	(120 )	49,019
U.S. agency securities	42,004	56	(17 )	42,043
Asset-backed securities	21,083	8	(34 )	21,057
U.S. Treasury securities	12,859	27	(5 )	12,881
Total short-term investments	125,056	120	(176 )	125,000
Cash, cash equivalents and short-term investments	\$215,438	\$120	\$(176 )	\$215,382

The following table summarizes the cost and estimated fair value of short-term fixed income securities classified as short-term investments based on stated maturities as of June 30, 2015:

	Amortized Cost (in thousands)	Estimated Fair Value
Less than 1 year	\$14,892	\$14,897
Due in 1 to 3 years	121,543	121,595
Total	\$136,434	\$136,492

As of June 30, 2015, the Company did not consider any of its investments to be other-than-temporarily impaired.

#### Note 3 — Fair value of financial instruments

The Company measures certain financial instruments at fair value on a recurring basis. The Company uses a three-tier fair value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1 valuations are based on quoted prices in active markets for identical assets or liabilities.

Level 2 valuations are based on inputs that are observable, either directly or indirectly, other than quoted prices included within Level 1. Such inputs used in determining fair value for Level 2 valuations include quoted prices in active markets for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 valuations are based on information that is unobservable and significant to the overall fair value measurement. All of the Company's cash equivalents and short-term investments are classified within Level 1 or Level 2.

The following table presents information about the Company's financial instruments that are measured at fair value as of June 30, 2015 and indicates the fair value hierarchy of the valuation (in thousands):

Table of Contents

Description	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Cash equivalents:			
Money market mutual funds	\$ 290	\$ 290	\$—
Total cash equivalents	290	290	—
Short-term investments:			
Corporate bonds	53,819	—	53,819
U.S. agency securities	46,907	—	46,907
Asset-backed securities	22,571	—	22,571
U.S. Treasury securities	12,905	—	12,905
Total short-term investments	136,202	—	136,202
Cash equivalents and short-term investments	\$ 136,492	\$ 290	\$ 136,202

The Company has restricted cash of \$1.2 million and \$0 within Other assets, respectively as of June 30, 2015, and December 31, 2014. The restricted cash is classified within Level 1.

The following table presents information about the Company's financial instruments that are measured at fair value as of December 31, 2014 and indicates the fair value hierarchy of the valuation (in thousands):

Description	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Cash equivalents:			
Money market mutual funds	\$ 793	\$ 793	\$—
Total cash equivalents	793	793	—
Short-term investments:			
Corporate bonds	49,019	—	49,019
U.S. agency securities	42,043	—	42,043
Asset-backed securities	21,057	—	21,057
U.S. Treasury securities	12,881	—	12,881
Total short-term investments	125,000	—	125,000
Cash equivalents and short-term investments	\$ 125,793	\$ 793	\$ 125,000

The convertible notes issued by the Company in August 2013 are shown on the accompanying consolidated balance sheets at their original issuance value, net of unamortized discount, and are not marked to market each period. The approximate fair value of the convertible notes as of June 30, 2015 and December 31, 2014 was \$125.4 million and \$111.2 million, respectively. The fair value of the convertible notes was determined using quoted market prices for similar securities, which, due to limited trading activity, are considered Level 2 in the fair value hierarchy.

The Company did not have any financial liabilities measured at fair value or any long-term debt other than the Convertible debt as of June 30, 2015 and December 31, 2014.

Note 4 — Other current liabilities

Other current liabilities balances were comprised of the following (in thousands):

10

---

Table of Contents

	June 30, 2015	December 31, 2014
Accrued Interest - Convertible Notes	941	938
Deferred rent	705	855
ESPP Withholding	636	776
	\$2,282	\$2,569
Note 5 — Credit Facility and Capital Leases		
Revolving Credit Facility		

On July 5, 2012, the Company, entered into a three-year credit agreement which provides for a secured revolving line of credit based on eligible accounts receivable up to \$30.0 million with a \$2.0 million letter of credit sublimit. On May 5, 2014, the Company entered into an amendment to the credit agreement which reduced the secured revolving line of credit to \$10.0 million. The quarterly commitment fee, payable in arrears, based on the available commitments is 0.30% per annum. There were no outstanding balances on the facility as of June 30, 2015.

The letter of credit for \$550,000 required under an operating lease agreement for office space at the Company's San Francisco headquarters expired on June 1, 2015. Any outstanding loans under the credit facility bear interest, at the Company's option, at a base rate determined in accordance with the credit agreement, minus 0.5%, or at a LIBOR rate plus 2.0%. Principal, together with all accrued and unpaid interest, was due and payable on July 5, 2015, the maturity date. At June 30, 2015, the interest rate for borrowings under the facility was 2.2%. The credit agreement contains customary affirmative and negative covenants, as well as financial covenants. The Company was in compliance with all of the covenants under the credit agreement as of June 30, 2015. The credit agreement expired on July 5, 2015.

## Letter of Credit

On February 3, 2015, the Company issued a \$1.2 million letter of credit in connection with a lease for a new San Francisco facility. The letter of credit is secured by \$1.2 million of a money market account which is considered restricted cash.

## Capital Leases

The Company has capital lease agreements that are collateralized by the underlying property and equipment and expire through September 2019. The weighted-average imputed interest rates for the capital lease agreements were 5.4% and 5.6% at June 30, 2015 and 2014, respectively.

Future minimum annual payments under capital lease obligations as of June 30, 2015 were as follows (in thousands):

	June 30, 2015
Years Ending December 31, 2015 (remaining six months)	\$95
2016	120
2017	66
2018	68
2019	51
Total	\$400

## Note 6 — Debt

## Senior Convertible Notes

In August 2013, the Company issued senior convertible notes (the "Notes") raising gross proceeds of \$150.0 million. The Notes are governed by an Indenture, dated August 13, 2013 (the "Indenture"), between the Company and Wells Fargo Bank, National Association, as trustee. The Notes will mature on August 1, 2018, unless earlier repurchased or converted, and





bear interest at a rate of 1.50% per year payable semi-annually in arrears on February 1 and August 1 of each year, commencing February 1, 2014.

The Notes are convertible at an initial conversion rate of 61.6770 of common stock per \$1,000 principal amount of Notes, which represents an initial conversion price of approximately \$16.21 per share of common stock, subject to anti-dilution adjustments upon certain specified events, including in certain circumstances, upon a make-whole fundamental change (as defined in the Indenture). Upon conversion, the Notes will be settled in cash, shares of the Company's common stock, or any combination thereof, at the Company's option.

Prior to February 1, 2018, the Notes are convertible only upon the following circumstances:

during any calendar quarter commencing after December 31, 2013, (and only during such calendar quarter), if for at least 20 trading days (whether or not consecutive) during the period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter, the last reported sale price of common stock on such trading day is greater than or equal to 130% of the applicable conversion price on such trading day;

during the five business day period after any five consecutive trading day period in which the trading price per \$1,000 principal amount of the Notes for each trading day of that five consecutive trading day period was less than 98% of the product of the last reported sale price of common stock and the applicable conversion rate on each such trading day; or

upon the occurrence of specified corporate events described in the Indenture.

The Notes were not convertible at June 30, 2015 under the circumstances listed above. However, the holders of the Notes may convert their Notes at any time on or after February 1, 2018, until the close of business on the second schedule trading day immediately preceding the maturity date, regardless of the foregoing circumstances.

The holders of the Notes may require the Company to repurchase all or a portion of their Notes at a cash repurchase price equal to 100% of the principal amount of the Notes being repurchased, plus accrued and unpaid interest, if any, upon a fundamental change (as defined in the Indenture). In addition, upon certain events of default (as defined in the Indenture), the trustee by notice to the Company, or the holders of at least 25% in principal amount of the outstanding Notes by notice to the Company and the trustee, may, and the trustee at the request of such holders shall, declare 100% of the principal amount of the Notes, plus accrued and unpaid interest, if any, on all the Notes to be due and payable. In case of certain events of bankruptcy, insolvency or reorganization involving the Company, 100% of the principal of and accrued and unpaid interest on the Notes will automatically become due and payable. The Notes were not subject to repurchase at June 30, 2015.

To account for the Notes at issuance, the Company separated the Notes into debt and equity components pursuant to the accounting standards for convertible debt instruments that may be fully or partially settled in cash upon conversion. The fair value of debt component was estimated using an interest rate for nonconvertible debt, with terms similar to the Notes, excluding the conversion feature. The carrying amount of the liability component was calculated by measuring the fair value of a similar liability that does not have an associated convertible feature. The excess of the principal amount of the Notes over the fair value of the debt component was recorded as a debt discount and a corresponding increase in additional paid-in capital. The debt discount is accreted to interest expense over the term of the Notes using the interest method. The amount recorded to additional paid-in capital is not to be remeasured as long as it continues to meet the conditions of equity classification. Upon issuance of the \$150.0 million of Notes, the Company recorded \$111.5 million to debt and \$38.5 million to additional paid-in capital.

The Company incurred transaction costs of approximately \$4.9 million related to the issuance of the Notes. In accounting for these costs, the Company allocated the costs to the debt and equity components in proportion to the allocation of proceeds from the issuance of the Notes to such components. Transaction costs allocated to the debt component of \$3.6 million are deferred as an asset and amortized to interest expense over the term of the Notes. The transaction costs allocated to the equity component of \$1.3 million were recorded to additional paid-in capital. The transactions costs allocated to the debt component were recorded as deferred offering costs in other non-current assets. The net carrying amount of the liability component of the Notes consists of the following (in thousands):

	June 30, 2015	December 31, 2014
Principal amount	\$150,000	\$150,000
Unamortized debt discount	(25,699	) (29,270
Net carrying amount	\$124,301	\$120,730

The following table presents the interest expense recognized related to the Notes (in thousands):

12

---

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Contractual interest expense at 1.5% per annum	\$562	\$562	\$1,125	\$1,125
Amortization of debt issuance costs	169	209	333	360
Accretion of debt discount	1,816	1,680	3,571	3,305
Total	\$2,547	\$2,451	\$5,029	\$4,790

The net proceeds from the Notes were approximately \$145.1 million after payment of the initial purchasers' discount and offering expense. The Company used approximately \$31.4 million of the net proceeds from the Notes to pay the cost of the Note Hedges described below, which was partially offset by \$21.8 million of the proceeds from the Company's sale of the Warrants also described below.

#### Note Hedges

Concurrent with the issuance of the Notes, the Company entered into note hedges ("Note Hedges") with certain bank counterparties, with respect to its common stock. The Company paid \$31.4 million for the Note Hedges. The Note Hedges cover approximately 9.25 million shares of the Company's common stock at a strike price of \$16.21 per share. The Note Hedges will expire upon the maturity of the Notes. The Note Hedges are intended to reduce the potential dilution to the Company's common stock upon conversion of the Notes and/or offset the cash payment in excess of the principal amount of the Notes the Company is required to make in the event that the market value per share of the Company's common stock at the time of exercise is greater than the conversion price of the Notes.

#### Warrants

Separately, the Company entered into warrant transactions, whereby it sold warrants to the same bank counterparties as the Note Hedges to acquire approximately 9.25 million shares of the Company's common stock at an initial strike price of \$21.02 per share ("Warrants"), subject to anti-dilution adjustments. The Company received proceeds of approximately \$21.8 million from the sale of the Warrants. If the fair value per share of the Company's common stock exceeds the strike price of the Warrants, the Warrants will have a dilutive effect on earnings per share, unless the Company elects, subject to certain conditions, to settle the Warrants in cash.

The amounts paid and received for the Note Hedges and the Warrants have been recorded in additional paid-in capital. The fair value of the Note Hedges and the Warrants are not remeasured through earnings each reporting period.

#### Note 7 — Commitments and Contingencies

##### Operating Leases

The Company leases its office space and certain equipment under noncancelable operating lease agreements with various expiration dates through November 30, 2022. Rent expense for the three months ended June 30, 2015 and 2014 was \$2.6 million and \$2.4 million, respectively, and for the six months ended June 30, 2015 and 2014 was \$4.8 million and \$4.6 million, respectively. The Company recognizes rent expense on a straight-line basis over the lease period and accrues for rent expense incurred but not paid.

In May 2015 the Company commenced a 7-year office lease expiring in November 2022 for a new corporate headquarters in San Francisco, California to occupy 24,394 square feet of space. The table below includes approximately \$13.3 million of minimum lease payments over the 7-year lease term.

Future annual minimum lease payments under all noncancelable operating leases as of June 30, 2015 were as follows (in thousands):

Table of Contents

	June 30, 2015
Years Ending December 31,	
2015 (remaining six months)	\$3,722
2016	6,769
2017	6,568
2018	6,224
2019	5,131
Thereafter	12,033
Total	\$40,447

## Other Contractual Obligations

In August 2013, the Company issued the Notes raising gross proceeds of \$150.0 million. The Notes will mature on August 1, 2018, unless earlier repurchased or converted, and bear interest at a rate of 1.50% per year payable semi-annually in arrears on February 1 and August 1 of each year, commencing February 1, 2014.

## Litigation

On July 8, 2015, a class action securities lawsuit, *Weller v. ServiceSource International, Inc. et al.*, was filed in the U.S. District Court for the Northern District of California (“Weller Lawsuit”) against Company and Company’s former Chief Executive Officer. The Weller Lawsuit was brought on behalf of purchasers of Company stock during the period January 22, 2014 through May 1, 2014. Plaintiffs allege that the defendants made false and misleading statements about Company’s actual and expected financial performance. Plaintiffs seek unspecified damages. The Company believes that the claims are meritless, and will vigorously defend it.

From time to time, the Company may be subject to litigation or threatened litigation arising in the ordinary course of our business. Although the results of litigation and claims cannot be predicted with certainty, the Company is currently not aware of any litigation or threats of litigation in which the final outcome could have a material adverse effect on our business, operating results, financial position, or cash flows. Regardless of the outcome, litigation can have an adverse impact on the Company because of defense and settlement costs, diversion of management resources, and other factors. The Company records a contingent liability when it is probable that a loss has been incurred and the amount is reasonably estimable in accordance with accounting for contingencies.

## Note 8 — Stock-Based Compensation

The following table summarizes the consolidated stock-based compensation expense included in the condensed consolidated statements of operations (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,	June 30,	June 30,	June 30,
	2015	2014	2015	2014
Cost of revenue	\$659	\$1,099	\$1,495	\$2,133
Sales and marketing	716	1,583	1,647	3,420
Research and development	444	736	991	1,437
General and administrative	1,158	1,932	3,411	3,942
Total stock-based compensation	\$2,977	\$5,350	\$7,544	\$10,932

## Determining Fair Value of Stock Awards

The Company estimates the fair value of stock option awards at the date of grant using the Black-Scholes option-pricing model. Options are granted with an exercise price equal to the fair value of the common stock as of the date of grant. Compensation expense is amortized net of estimated forfeitures on a straight-line basis over the requisite service period of the options, which is generally four years. Restricted stock, upon vesting, entitles the holder to one share of common stock for each



Table of Contents

restricted stock unit or award and has a purchase price of \$0.0001 per share, which is equal to the par value of the Company's common stock, and vests over four years. The fair value of the restricted stock is based on the Company's closing stock price on the date of grant, and compensation expense, net of estimated forfeitures, is recognized on a straight-line basis over the vesting period.

Option and restricted stock activity under the 2011 Plan for the six months ended June 30, 2015 was as follows (shares in thousands)

	Shares and Units Available for Grant	Options Outstanding		Restricted Stock Outstanding
		Number of Shares	Weighted-Average Exercise Price	Number of Shares
Outstanding — December 31, 2014	5,982	10,070	\$5.08	5,476
Additional shares reserved under the 2011 equity incentive plan	3,364	—	—	—
Granted	(3,497	) 2,689	4.01	808
Options exercised/ Restricted stock released	—	(261	) 5.60	(1,439
RSU shares withheld for taxes	156	—	—	156
Canceled/Forfeited	2,660	(1,666	) 5.60	(995
Outstanding — June 30, 2015	8,665	10,832	4.76	4,006

The weighted average grant-date fair value of employee stock options granted during the three months ended June 30, 2015 and 2014 was \$1.30 and \$1.59 per share, respectively and for the six months ended June 30, 2015 and 2014 was \$1.30 and \$2.15 per share, respectively. The unamortized grant date fair value of both stock options and restricted stock awards totaled \$24.2 million at June 30, 2015.

#### Note 9 — Income Taxes

The Company is subject to taxation in the United States and various state and foreign jurisdictions. Earnings from non-U.S. activities are subject to local country income tax. The Company computes its quarterly income tax provision by using a forecasted annual effective tax rate and adjusts for any discrete items arising during the quarter. The primary difference between the effective tax rate and the federal statutory tax rate relates to the valuation allowances on the Company's net operating losses and foreign tax rate differences. The Company is currently undergoing examination of the California Franchise Tax Returns relating to California state income taxes of its U.S. operating subsidiary for the years 2008 through 2010. The tax years 2008 through 2014 remain subject to examination by federal state and foreign tax authorities. The Company does not provide for federal income taxes on the undistributed earnings of its foreign subsidiaries as such earnings are to be reinvested indefinitely outside the U.S.

Consistent with the Company's practice in prior periods for assessing realization of deferred tax assets, management believes based on the available objective evidence it is more likely than not that the tax benefits of the U.S. and Singapore losses will not be realized by the end of 2015. As a result, the Company continues to provide a valuation allowance for all U.S. federal net deferred tax assets, for all Singapore net deferred tax assets, and for substantially all of the Company's state deferred tax assets other than those as described below.

Management assesses the available positive and negative evidence to estimate if sufficient future taxable income will be generated to use the existing deferred tax assets. A significant piece of objective negative evidence evaluated was a recent state tax law change in May 2015 that impacts the manner in which the Company apportions revenue. Such objective evidence limits the ability to consider other subjective evidence such as our projections for future growth. On the basis of this evaluation, as of June 30, 2015, a valuation allowance of \$0.6 million has been recorded to record only the portion of the state deferred tax asset that is more likely than not to be realized. Note that changes in tax laws

and rates may affect other deferred tax assets and liabilities recorded in the future. These changes are accounted for in the period of enactment and thus are reflected in the Company's June 30, 2015 financial results. As a result of the recent state tax law change discussed above, the Company has also recorded approximately \$0.3 million as a discrete item in our tax provision for the second quarter of 2015.

The Company's gross amount of unrecognized tax benefits was \$0.9 million as of June 30, 2015 and as of December 31, 2014, \$0.1 million of which, if recognized, would affect the Company's effective tax rate.

Table of Contents

## Note 10 — Segment and Geographical Information

The Company's Chief Operating Decision Maker (CODM), its Chief Executive Officer, evaluates the performance of its two operating segments based on net revenue and gross profit. Gross profit for each segment includes revenues and the related cost of revenue directly attributable to the segment. The Company does not allocate sales and marketing, research and development, or general and administrative expenses to its operating segments because management does not include the information in its measurement of the performance of the operating segments. The Company does not evaluate its operating segments using discrete asset information.

**Managed Services-** The Company's managed services solution consists of end-to-end management and optimization of the recurring revenue process, including quoting, selling and business intelligence. The Company's managed services business is built on its pay-for-performance model, whereby customers pay the Company a commission based on renewal sales that it generates on their behalf. The Company's managed services offerings include quoting and selling services, in which dedicated service teams have specific expertise in the customers' businesses, are deployed under the Company's customers' brands and follow a sales process tailored specifically to increase service contract renewals.

**Cloud and Business Intelligence-** The Company's cloud and business intelligence solution consist of its subscription sales and professional services to deploy the Company's solutions. Subscription sales consists of selling subscriptions to Renew OnDemand and ServiceSource Revenue Analytics, both SaaS applications. The foundation of the Company's cloud solution is Renew OnDemand, a SaaS-based renewal management system based on its data warehouse of transactional, analytical and industry data that grows with each service renewal transaction and customer.

Summarized financial information by reporting segments based on the Company's internal management reporting and as utilized by the Company's CODM, is as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net Revenue				
Managed Services	\$56,223	\$58,575	\$114,237	\$117,144
Cloud and Business Intelligence	5,390	7,422	13,573	15,669
	61,613	65,997	127,810	132,813
Gross Profit				
Managed Services	17,314	15,986	33,332	33,249
Cloud and Business Intelligence	1,607	1,493	5,971	3,451
	18,921	17,479	39,303	36,700
Unallocated operating expenses	28,500	36,349	57,073	71,601
Loss from operations	\$(9,579)	\$(18,870)	\$(17,770)	\$(34,901)

The Company's business is geographically diversified. For the six months ended June 30, 2015, 65% of our net revenue was earned in North America and Latin America ("NALA"), 24% in Europe, Middle East and Africa ("EMEA") and 11% in Asia Pacific-Japan ("APJ"). Net revenue for a particular geography generally reflects commissions earned from sales of service contracts managed from our sales centers in that geography and subscription sales and professional services to deploy the Company's solutions. Predominantly all of the service contracts sold and managed by our sales centers relate to end customers located in the same geography. All of NALA net revenue represents revenue generated in the United States.

Summarized financial information by geographic location based on the Company's internal management reporting is as follows (in thousands):



Table of Contents

	Three Months Ended		Six Months Ended	
	June 30, 2015	2014	June 30, 2015	2014
Net revenue				
NALA	\$40,859	\$43,140	\$83,049	\$85,958
EMEA	13,743	16,354	31,206	34,442
APJ	7,011	6,503	13,555	12,413
Total net revenue	\$61,613	\$65,997	\$127,810	\$132,813

17

---

Table of Contents

## Note 11 — Restructuring and other

The Company announced at the beginning of the third quarter of 2014 a restructuring effort to better align our cost structure with current revenue levels. The restructuring plans are accounted for in accordance with ASC 420, Exit or Disposal Cost Obligations. The Company recognized restructuring and other charges of \$3.0 million and \$3.7 million during the three and six month periods ended June 30, 2015. Restructuring costs includes separation payments, related employee benefits and retention bonuses. Other costs include \$0.6 million of severance related expenses and \$2.6 million of stock based compensation related to the accelerated vesting of certain equity awards granted to the Company's former interim CFO and CEO.

Restructuring and other activities for the period ended June 30, 2015 is summarized as follows (in thousands):

	Restructuring	Other	Total	
Restructuring and other liability at December 31, 2014	\$364	\$251	\$615	
Restructuring and other charges	355	3,384	3,739	
Cash paid	(717	) (652	) (1,369	)
Acceleration of stock-based compensation expense in additional paid-in capital	—	(2,579	) (2,579	)
Restructuring and other liability at June 30, 2015	\$2	\$404	\$406	

Table of Contents

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with our condensed consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q and with our Annual Report on Form 10-K/A for the year ended December 31, 2014.

This Quarterly Report on Form 10-Q contains "forward-looking statements" that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. These forward-looking statements include, but are not limited to, statements related to changes in market conditions that impact our ability to generate service revenue on behalf of our customers; errors in estimates as to the service revenue we can generate for our customers; our ability to attract new customers and retain existing customers; risks associated with material defects or errors in our software or the effect of data security breaches; our ability to adapt our solution to changes in the market or new competition; our ability to improve our customers' renewal rates, margins and profitability; our recurring revenue opportunity under management; our ability to increase our revenue and contribution margin over time from new and existing customers, including as a result of sales of our next-generation technology platform, Renew OnDemand, on a stand-alone subscription basis; our ability to implement Renew OnDemand, ServiceSource Revenue Analytics (formerly Scout Analytics), ServiceSource Customer Success or our other SaaS offerings; our strategy with respect to our business services and SaaS businesses, cloud offering and managed services and cost allocation and management efforts; the potential effect of mergers and acquisitions on our customer base; business strategies and new sales initiatives; technology development; protection of our intellectual property; investment and financing plans; liquidity, our leverage consisting of convertible notes and related matters concerning our note hedges and warrants; our competitive position; the effects of competition; industry environment; potential growth opportunities; and our expected benefits from the acquisition of Scout. Forward-looking statements are also often identified by the use of words such as, but not limited to, "anticipate," "believe," "can," "continue," "could," "estimate," "expect," "intend," "may," "plan," "project," "se," "target," "will," "would," and similar expressions or variations intended to identify forward-looking statements. These statements are based on the beliefs and assumptions of our management based on information currently available to management. Such forward-looking statements are subject to risks, uncertainties and other important factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section of this Quarterly Report on Form 10-Q titled "Risk Factors." Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

All dollar amounts expressed as numbers in this MD&A (except per share amounts) are in millions.

**OVERVIEW**

ServiceSource International, Inc. (NASDAQ: SREV) is the global leader in customer success and recurring revenue growth solutions across the Revenue Lifecycle. As a subset of the Customer Lifecycle Management business segment, the Revenue Lifecycle addresses critical elements of customer success, recurring revenue growth, and renewal processes, which include on-boarding, adoption, upsell, cross-sell, retention and renewals. Our solutions are designed to optimize the retention rates and recurring revenue performance for our customers to drive revenue growth and decrease churn from their own existing business-to-business ("B2B") customers.

Our solutions are comprised of managed services, cloud software and best-practice processes. In delivering our services, we leverage industry and company data, leading-edge technology and best-practices drawn from our deep database of renewal benchmarks. By integrating managed services, cloud software and data, we provide end-to-end management and optimization of the customer onboarding, adoption, subscription and service-contract renewal process.

Our managed services business leverages either a flat-rate or a pay-for-performance model whereby our customers pay us a commission based on renewal sales that we generate on their behalf. Our cloud software offerings currently include: ServiceSource Revenue Analytics (formerly Scout Analytics), Renew OnDemand and the ServiceSource

Customer Success application, all of which automate and provide data-driven insights into these highly valuable but typically manual business processes. Our cloud offerings and managed services can drive higher subscription, maintenance and support revenue while improving customer retention and increasing business predictability.

The scalability of our solution enables us to sell in over 40 languages from six sales centers around the globe. Our solution is designed to optimize recurring revenue across different revenue models, distribution models, and segments, including hardware, software, SaaS, industrial systems, information and media, as well as technology-enabled health care and life sciences.

## Table of Contents

As part of our introduction of Renew OnDemand in prior years, we had been expanding the organization, investing in our engineering and sales and marketing organization primarily in advance of our goal of an increase in revenues from both existing customers and new customers due to increased adoption of our new SaaS platform. We also acquired Scout Analytics in January 2014, believing that Scout Analytics' new business acquisitions in the months prior to the merger demonstrated growth potential for the near term. For both SaaS platforms, we experienced a slower adoption rate than we originally planned. As a result of this slower adoption, the Company announced a restructuring plan in the third quarter of 2014, with the intention of reducing the resources to better match the expected revenues. In addition, with the incurred losses in combination with lower stock price, we performed a goodwill and long lived asset impairment analysis in the third and fourth quarters of 2014. In 2014, we recorded a goodwill and other intangible asset impairment of \$25.1 million for the Cloud and Business Intelligence segment.

### Key Business Metrics

In assessing the performance of our business, we consider a variety of business metrics in addition to the financial metrics discussed below under, “-Basis of Presentation.” These key metrics include recurring revenue opportunity under management and number of engagements.

**Recurring Revenue Opportunity Under Management.** At December 31, 2014, we estimated our opportunity under management to be over \$13.5 billion. Opportunity under management is a forward-looking metric and is our estimate, as of a given date, of the value of all end customer service contracts that we will have the opportunity to service on behalf of our customers over the subsequent twelve-month period. Opportunity under management is not a measure of our expected revenue. Opportunity under management reflects our estimate for a forward twelve-month period and should not be used to estimate our opportunity for any particular quarter within that period. The value of end customer contracts actually delivered during a twelve-month period should not be expected to occur in even quarterly increments due to seasonality and other factors impacting our customers and their end customers. We estimate the value of such end customer contracts based on a combination of factors, including the value of end customer contracts made available to us by our customers in past periods, the minimum value of end customer contracts that our customers are required to give us the opportunity to sell pursuant to the terms of our contracts with them, periodic internal business reviews of our expectations as to the value of end customer contracts that will be made available to us by our customers, the value of end customer contracts included in the Service Performance Analysis (“SPA”) and collaborative discussions with our customers assessing their expectations as to the value of service contracts that they will make available to us for sale. While the minimum value of end customer contracts that our customers are required to give us represents a portion of our estimated opportunity under management, a significant portion of the opportunity under management is estimated based on the other factors described above. As our experience with our business, our customers and their contracts has grown, we have continually refined the process, improved the assumptions and expanded the data related to our calculation of opportunity under management. When estimating recurring revenue opportunity under management, we must, to a large degree, rely on the assumptions described above, which may prove incorrect. These assumptions are inherently subject to significant business and economic uncertainties and contingencies, many of which are beyond our control. Our estimates therefore may prove inaccurate, causing the actual value of end customer contracts delivered to us in a given twelve-month period to differ from our estimate of opportunity under management. These factors include:

- the extent to which customers deliver a greater or lesser value of end customer contracts than may be required or otherwise expected;
- roll-overs of unsold service contract renewals from prior periods to the current period or future periods;
- changes in the pricing or terms of service contracts offered by our customers;
- increases or decreases in the end customer base of our customers;
- the extent to which the renewal rates we achieve on behalf of a customer early in an engagement affect the amount of opportunity that the customer makes available to us later in the engagement;
- customer cancellations of their contracts with us; and

- changes in our customers' businesses, sales organizations, management, sales processes or priorities.

Our managed services revenue also depends on our close rates and commissions. Our close rate is the percentage of opportunity under management that we renew on behalf of our customers. Our commission rate is an agreed-upon percentage of the renewal value of end customer contracts that we sell on behalf of our customers.

Our close rate is impacted principally by our ability to successfully sell service contracts on behalf of our customers. Other factors impacting our close rate include: the manner in which our customers price their service contracts for sale to their end customers; the stage of life-cycle associated with the products and underlying technologies covered by the service contracts offered to the end customer; the extent to which our customers or their competitors introduce new products or underlying

## Table of Contents

technologies; the nature, size and age of the service contracts; and the extent to which we have managed the renewals process for similar products and underlying technologies in the past.

In determining commission rates for an individual engagement, various factors, including our close rates, as described above, are evaluated. These factors include: historical, industry-specific and customer-specific renewal rates for similar service contracts; the magnitude of the opportunity under management in a particular engagement; the number of end customers associated with these opportunities; and the opportunity to receive additional performance commissions when we exceed certain renewal levels. We endeavor to set our commission rates at levels commensurate with these factors and other factors that may be relevant to a particular engagement. Accordingly, our commission rates vary, often significantly, from engagement to engagement. In addition, we sometimes agree to lower commission rates for engagements with significant opportunity under management.

In 2014, we experienced a decline in opportunity under management for our managed services business due to a number of contraction and nonrenewal by some of our customers. We expect the reduction in opportunity under management experienced in 2014 will continue to impact our 2015 revenues until we can replace this decline in opportunity under management.

**Number of Engagements.** We track the number of engagements we have with our customers. We often have multiple engagements with a single customer, particularly where we manage the sales of service renewals relating to different product lines, technologies, types of contracts or geographies for the customer. When the set of renewals we manage on behalf of a customer is associated with a separate customer contract or a distinct product set, type of end customer contract or geography and therefore requires us to assign a service sales team to manage the renewals, we designate the set of renewals, and associated revenues and costs to us as a unique engagement. For example, we may have one engagement consisting of a service sales team selling maintenance contract renewals of a particular product for a customer in the United States and another engagement consisting of a sales team selling warranty contract renewals of a different product for the same customer in Europe. These would count as two engagements. We had 164 and 196 engagements as of June 30, 2015 and 2014 respectively.

### Factors Affecting our Performance

**Sales Cycle.** We sell our integrated solution through our sales organization. At the beginning of the sales process, our quota-carrying sales representatives contact prospective customers and educate them about our offerings. Educating prospective customers about the benefits of our solution can take time, as many of these prospects have not historically relied upon integrated solutions like ours for service revenue management, nor have they typically put out a formal request for proposal or otherwise made a decision to focus on this area. As part of our sales process, we utilize our solutions design team to perform a SPA of our prospect's service revenue. The SPA includes an analysis of best practices and benchmarks the prospect's service revenue against industry peers. Through the SPA process, which typically takes several weeks, we are able to assess the characteristics and size of the prospect's service revenue, identify potential areas of performance improvement, and formulate our proposal for managing the prospect's service revenue. The length of our sales cycle for a new customer, inclusive of the SPA process and measured from our first formal discussion with the customer until execution of a new customer contract, is typically longer than six months and has increased in recent periods.

We generally contract with new customers to manage a specified portion of their service revenue opportunity, such as the opportunity associated with a particular product line or technology, contract type or geography. We negotiate the engagement specific terms of our customer contracts, including commission rates, based on the output of the SPA, including the areas identified for improvement. Once we demonstrate success to a customer with respect to the opportunity under contract, we seek to expand the scope of our engagement to include other opportunities with the customer. For some customers, we manage all or substantially all of their service contract renewals.

For cloud offerings, the SPA may be more limited and focused on the benefits of the respective technology and therefore may take less time.

**Implementation Cycle.** After entering into an engagement with a new customer, and to a lesser extent after adding an engagement with an existing customer, we incur sales and marketing expenses related to the commissions owed to our sales personnel. The commissions are based on the estimated total contract value, with a material portion of the commission expensed upfront with the remaining portion expensed ratably over a period of twelve to fourteen months. We also make upfront investments in technology and personnel to support the engagement. These expenses are typically incurred one to three months before we begin generating sales and recognizing revenue. Accordingly, in a given quarter, an increase in new customers, and, to a lesser extent, an increase in engagements with existing customers, or a significant increase in the contract



## Table of Contents

value associated with such new customers and engagements, will negatively impact our gross margin and operating margins until we begin to achieve anticipated sales levels associated with the new engagements, which is typically two-to-three quarters after we begin selling contracts on behalf of our customers.

Although we expect new customer engagements to contribute to our operating profitability over time, in the initial periods of a customer relationship, the near term impact on our profitability can be negatively impacted by slower-than anticipated growth in revenues for these engagements as well as the impact of the upfront costs we incur, the lower initial level of associated service sales team productivity and lack of mature data and technology integration with the customer. As a result, an increase in the mix of new customers as a percentage of total customers may initially have a negative impact on our operating results. Similarly, a decline in the ratio of new customers to total customers may positively impact our near-term operating results.

**Contract Terms.** Substantially all of our managed services revenue comes from our pay-for-performance model. Under our pay-for-performance model, we earn commissions based on the value of service contracts we sell on behalf of our customers. In some cases, we earn additional performance-based commissions for exceeding pre-determined service renewal targets.

Our new customer contracts typically have an initial term between two and four years. Our contracts generally require our customers to deliver a minimum value of qualifying service revenue contracts for us to renew on their behalf during a specified period. To the extent that our customers do not meet their minimum contractual commitments over a specified period, they may be subject to fees for the shortfall. Our customer contracts are cancelable on relatively short notice, subject in most cases to the payment of an early termination fee by the customer. The amount of this fee is based on the length of the remaining term and value of the contract.

We invoice our customers on a monthly basis based on commissions we earn during the prior month, and with respect to performance-based commissions, on a quarterly basis based on our overall performance during the prior quarter. Amounts invoiced to our customers are recognized as revenue in the period in which our services are performed or, in the case of performance commissions, when the performance condition is determinable. Because the invoicing for our services generally coincides with or immediately follows the sale of service contracts on behalf of our customers, we do not generate or report a significant deferred revenue balance. However, the combination of factors such as, but not limited to minimum contractual commitments, the performance improvement potential identified by our SPA process, our success in generating improved renewal rates for our customers, and our customers' historical renewal rates, for example, help to provide us with revenue visibility, but may all affect our performance favorably or unfavorably.

**M&A Activity.** Our customers, particularly those in the technology sector, participate in an active environment for mergers and acquisitions. Large technology companies have maintained active acquisition programs to increase the breadth and depth of their product and service offerings and small and mid-sized companies have combined to better compete with large technology companies. A number of our customers have merged, purchased other companies or been acquired by other companies. We expect merger and acquisition activity to continue to occur in the future.

The impact of these transactions on our business can vary. Acquisitions of other companies by our customers can provide us with the opportunity to pursue additional business to the extent the acquired company is not already one of our customers. Similarly, when a customer is acquired, we may be able to use our relationship with the acquired company to build a relationship with the acquirer. In some cases we have been able to maintain our relationship with an acquired customer even where the acquiring company handles its other service contract renewals through internal resources. In other cases, however, acquirers have elected to terminate or not renew our contract with the acquired company.

Economic Conditions and Seasonality. An improving economic outlook generally has a positive, but mixed, impact on our business. As with most businesses, improved economic conditions can lead to increased end customer demand and sales. In particular, within the technology sector, we believe that the recent economic downturn led many companies to cut their expenses by choosing to let their existing maintenance, support and subscription agreements lapse. An improving economy may have the opposite effect.

However, an improving economy may also cause companies to purchase new hardware, software and other technology products, which we generally do not sell on behalf of our customers, instead of purchasing maintenance, support and subscription services for existing products. To the extent this occurs, it would have a negative impact on our opportunities in the near term that would partially offset the benefits of an improving economy.

## Table of Contents

We believe the current uncertainty in the economy, combined with shifting market forces toward subscription-based models, is impacting a number of our customers and prospective customers, particularly in the traditional enterprise software and hardware segments. These forces have placed pressure on end customer demand for their renewal contracts and also have led to some slower decision making in general. This economic and industry environment has adversely affected the conversion rates for end customers and contracts. To the extent these conditions continue they will impact our future revenues.

In addition to the uncertainty in the macroeconomic environment, we experience a seasonal variance in our revenue typically for the third quarter of the year as a result of lower or flat renewal volume corresponding to the timing of our customers' product sales particularly in the international regions. The impact of this seasonal fluctuation can be amplified if the economy as a whole is experiencing disruption or uncertainty, leading to deferral of some renewal decisions. As we increase our subscription revenue base, this seasonality will become less apparent. However for at least the next couple years, we would expect this pattern to continue.

Establishment of "Software-as-a-Service" Business unit. Within the software industry, there is a growing trend toward providing software to customers using a software-as-a-service ("SaaS") model. Under this model, SaaS companies provide access to software applications to customers on a remote basis, and provide their customers with a subscription to use the software, rather than licensing software to their customers.

We have several SaaS-based applications that we develop and support: Renew OnDemand (our purpose-built offering to manage and maximize recurring revenue), ServiceSource Revenue Analytics (formerly Scout Analytics, our SaaS offering to help companies with predictive analytics for recurring revenue), and other SaaS cloud offerings such as ServiceSource Customer Success. Our research and development costs are primarily related to these SaaS based applications. We intend to maintain customer support, training and professional service organizations to support deployments of our solutions. Our current spending incorporates a level of investment required for development of our products and are targeted at improving the tools and infrastructure that will make the product easier to deploy and support in the future. We believe that the level of effort to deploy and maintain these applications will decline over time, due to product development investments made in 2014 to improve the application layer of the solutions and to improve the underlying database architecture and reduce the overall cost of our cloud infrastructure. As a result, we expect costs to decline in 2015 and rise more slowly or at the same pace as revenue growth in future years.

### Basis of Presentation

#### Net Revenue

Substantially all of our net revenue is attributable to commissions we earn from the sale of renewals of maintenance, support and subscription agreements on behalf of our customers. We generally invoice our customers for our services in arrears on a monthly basis for sales commissions, and on a quarterly basis for certain performance sales commissions; accordingly, we typically have no deferred revenue related to these services. We do not set the price, terms or scope of services in the service contracts with end customers and do not have any obligations related to the underlying service contracts between our customers and their end customers.

We also earn revenue from the sale of subscriptions to our cloud based applications. To date, subscription revenue has been a small percentage of total revenue. We expect revenues generated from subscriptions of Renew OnDemand and ServiceSource SaaS cloud offerings to remain flat for the remainder of 2015 due to subscription losses from our initial customers. Subscription fees are accounted for separately from our managed service commissions, and they are billed in advance over a monthly, quarterly or annual basis. Subscription revenue is typically recognized ratably over the related subscription term.

We have generated a significant portion of our revenue from a limited number of customers. Our top ten customers accounted for 55% and 50% of our net revenue for the six months ended June 30, 2015 and 2014, respectively.

Effective April 2015, our largest customer reduced the scope of our managed services engagement with us and its subscription of our legacy system. Our opportunity under management reflects this reduction as of December 31, 2014.

The loss of revenue from any of our top customers for any reason, including the failure to renew our contracts, termination of some or all of our services, a change of relationship with any of our key customers or their acquisition, can cause a significant decrease in our revenue. We experienced a slight decrease in revenue in the three and six months ended on June 30, 2015 due to customer cancellation and reductions, including among some of our top customers, in excess of new customer additions and expansions for the managed services segment. The customer cancellations and reductions in the second half of

## Table of Contents

2014 were higher than our historical rates, and we have continued to experience the effects of these cancellations and reductions on our revenue in the second quarter of 2015.

Our business is geographically diversified. Through the first half of 2015, 65% of our net revenue was earned in North America and Latin America (“NALA”), 24% in Europe, Middle East and Africa (“EMEA”) and 11% in Asia Pacific-Japan (“APJ”). Net revenue for a particular geography generally reflects commissions earned from sales of service contracts managed from our sales centers in that geography. Predominantly all of the service contracts sold and managed by our sales centers relate to end customers located in the same geography. In addition, our Kuala Lumpur location is also our global sales operations center where we have centralized, for our worldwide operations, the key contract renewal processes that do not require regional expertise, such as customer data management and quoting. We do not generate any customer revenue out of Kuala Lumpur, so it is effectively a cost center which contributes to our APJ region.

### Cost of Revenue and Gross Profit

Our cost of revenue expenses include employee compensation, technology costs, including those related to the delivery of our cloud-based solutions, and allocated overhead costs. Compensation includes salary, bonus, benefits and stock-based compensation for our dedicated service sales teams. Our allocated overhead includes costs for facilities, information technology and depreciation, including amortization of internal-use software associated with our service revenue technology platform and cloud applications. Allocated costs for facilities consist of rent, maintenance and compensation of personnel in our facilities departments. Our allocated costs for information technology include costs associated with third-party data centers where we maintain our data servers, compensation of our information technology personnel and the cost of support and maintenance contracts associated with computer hardware and software. To the extent our customer base or opportunity under management expands, we may need to hire additional service sales personnel and invest in infrastructure to support such growth. We currently expect that our cost of revenue will fluctuate significantly and may increase on an absolute basis and as a percentage of revenue in the near term, including for the reasons discussed above under, “-Factors Affecting Our Performance-Implementation Cycle”. We are currently taking measures to reduce the costs to deliver our solutions and support our customer engagements, in order to improve our gross profit. Over the remaining quarters in 2015, we expect to see current cost reduction offset by investments we are making to drive further reductions to our cost to deliver and improved gross profit in 2016. We are also evaluating additional measures to further reduce our costs of revenue as opportunity under management has declined and we now are delivering our SAAS offerings on a more focused criteria than our initial engagements.

### Operating Expenses

**Sales and Marketing.** Sales and marketing expenses consist primarily of compensation and sales commissions for our sales and marketing staff, allocated expenses and marketing programs and events. We sell our solutions through our global sales organization, which is organized across three geographic regions: NALA, EMEA and APJ. Our commission plans provide that payment of commissions to our sales representatives is contingent on their continued employment, and we recognize expense over a period that is generally between twelve and fourteen months following the execution of the applicable contract. When commissions are paid out upon contract signing and are not contingent on future payments and continued employment, we expense the sales commission upon contract signing. We currently expect sales and marketing expenses to decline in 2015 and decrease or remain flat as a percentage of revenue in future years.

**Research and Development.** Research and development expenses consist primarily of compensation, allocated costs and the cost of third-party service providers. We focus our research and development efforts on developing new products and related applications for revenue analytics. In connection with the development and enhancements of our SaaS cloud applications, we capitalize certain expenditures related to the development and enhancement of internal-use software related to our technology platform. We expect research and development spending to decline in

2015 and decrease or remain flat as a percentage of revenue in future years.

**General and Administrative.** General and administrative expenses consist primarily of compensation for our executive, human resources, finance and legal functions, and related expenses for professional fees for accounting, tax and legal services, as well as allocated expenses. We expect that our general and administrative expenses will remain flat or slightly lower on an absolute basis as we streamline our operations where possible.

**Restructuring and other.** Restructuring and other expenses consist primarily of employees' severance payments, related employee benefits, retention bonuses and charges related to cancellation of contracts.

Interest expense and other, net

24

---

## Table of Contents

Interest expense. Interest expense consists primarily of interest expense associated with our convertible debt, fees related to our credit facility, capital lease payments; accretion of debt discount; and amortization of debt issuance costs. We recognize accretion of debt discount and amortization of interest costs using the effective interest method. We expect our interest expense to increase slightly in 2015 from accretion of debt discount, amortization of deferred financing costs and contractual interest costs as a result of our August 2013 issuance of \$150.0 million aggregate principal amount of convertible notes due August 2018.

Other, net. Other, net consists primarily of the interest income earned on our cash, cash equivalents and marketable securities investments and foreign exchange gains and losses. We expect other income to vary depending on the movement in foreign currency exchange rates and the related impact on our foreign exchange gain (loss) and the return of interest on our investments.

### Income Tax Provision

We account for income taxes using an asset and liability method, which requires the recognition of taxes payable or refundable for the current year and deferred tax assets and liabilities for the expected future tax consequences of temporary differences that currently exist between the tax basis and the financial reporting basis of our taxable subsidiaries' assets and liabilities using the enacted tax rates in effect for the year in which the differences are expected to reverse. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in operations in the period that includes the enactment date. The measurement of deferred tax assets is reduced, if necessary, by the amount of any tax benefits that, based on available evidence, are not expected to be realized.

We evaluate our ability to realize the tax benefits associated with deferred tax assets on a jurisdictional basis. This evaluation utilizes the framework contained in ASC 740, Income Taxes, wherein management analyzes all positive and negative evidence available at the balance sheet date to determine whether all or some portion of our deferred tax assets will not be realized. Under this guidance, a valuation allowance must be established for deferred tax assets when it is more likely than not (a probability level of more than 50 percent) that they will not be realized. In assessing the realization of our deferred tax assets, we consider all available evidence, both positive and negative.

In performing our evaluation, we place significant emphasis on guidance contained in ASC 740, which states that "a cumulative loss in recent years is a significant piece of negative evidence that is difficult to overcome."

We account for unrecognized tax benefits using a more-likely-than-not threshold for financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. We establish reserves for tax-related uncertainties based on estimates of whether, and the extent to which, additional taxes will be due. We record an income tax liability, if any, for the difference between the benefit recognized and measured and the tax position taken or expected to be taken on our tax returns. To the extent that the assessment of such tax positions change, the change in estimate is recorded in the period in which the determination is made. The reserves are adjusted in light of changing facts and circumstances, such as the outcome of a tax audit. The provision for income taxes includes the impact of reserve provisions and changes to reserves that are considered appropriate.

### Results of Operations

The table below sets forth our consolidated results of operations for the periods presented. The period-to-period comparison of financial results presented below is not necessarily indicative of financial results to be achieved in future periods.

Table of Contents

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
	(in thousands)			
Net revenue	\$61,613	\$65,997	\$127,810	\$132,813
Cost of revenue	42,692	48,518	88,507	96,113
Gross profit	18,921	17,479	39,303	36,700
Operating expenses:				
Sales and marketing	10,165	17,212	21,000	32,883
Research and development	4,646	6,881	9,468	13,597
General and administrative	10,701	12,256	22,866	25,121
Restructuring and other	2,988	—	3,739	—
Total operating expenses	28,500	36,349	57,073	71,601
Loss from operations	(9,579 )	(18,870 )	(17,770 )	(34,901 )
Interest expense and other, net	(2,739 )	(2,196 )	(4,584 )	(4,770 )
Loss before income taxes	(12,318 )	(21,066 )	(22,354 )	(39,671 )
Income tax provision	1,089	26	1,223	161
Net loss	\$(13,407 )	\$(21,092 )	\$(23,577 )	\$(39,832 )

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
	(in thousands)			
Includes stock-based compensation of:				
Cost of revenue	\$659	\$1,099	\$1,495	\$2,133
Sales and marketing	716	1,583	1,647	3,420
Research and development	444	736	991	1,437
General and administrative	1,158	1,932	3,411	3,942
Total stock-based compensation	\$2,977	\$5,350	\$7,544	\$10,932

The following table sets forth our operating results as a percentage of net revenue:

	Three Months Ended		Six Months Ended		
	June 30,		June 30,		
	2015	2014	2015	2014	
	(as % of net revenue)				
Net revenue	100	% 100	% 100	% 100	%
Cost of revenue	69	% 74	% 69	% 72	%
Gross profit	31	% 26	% 31	% 28	%
Operating expenses:					
Sales and marketing	16	% 26	% 16	% 25	%
Research and development	8	% 10	% 7	% 10	%
General and administrative	17	% 19	% 18	% 19	%
Restructuring and other	5	% —	% 3	% —	%
Total operating expenses	46	% 55	% 44	% 54	%
Loss from operations	(15	)% (29	)% (13	)% (26	)%





Table of Contents

Three months ended June 30, 2015 and June 30, 2014

## Net Revenue

	Three Months Ended June 30, 2015		2014		Change	% Change
	Amount (in thousands)	% of Net Revenue	Amount	% of Net Revenue		
Net revenue						
Managed Services	\$56,223	91	% \$58,575	90	% \$(2,352)	) (4) %
Cloud and Business Intelligence	5,390	9	% 7,422	10	% (2,032)	) (27) %
Total net revenue	\$61,613	100	% \$65,997	100	% \$(4,384)	) (7) %

Net revenue decreased \$4.4 million, or 7%, for the second quarter of 2015 compared to the second quarter of 2014. The overall decrease in revenue was due to customer cancellations and reductions in excess of new customer additions from previous quarter. Customer cancellations and reductions in the second quarter of 2015 were lower than previous quarters but continue to be slightly more than new business generated. We expect the effects of prior quarters' cancellations and reductions on our revenue to continue through the remainder of 2015.

Managed services revenue decreased \$2.4 million, or 4%, for the second quarter of 2015 compared to the second quarter of 2014 due to customer cancellations. The customer cancellations and reductions occurred primarily in the second half of 2014 and are expected to continue to impact 2015 revenue.

The \$2.0 million, or 27%, decrease in revenue from our Cloud and Business Intelligence ("CBI") for the second quarter of 2015 compared to the second quarter of 2014, was attributable to a loss of subscription revenue related to the elimination of certain services provided to one of our largest customers.

## Cost of Revenue and Gross Profit

	Three Months Ended June 30, 2015		2014		Change	% Change
	Amount (in thousand)	% of Net Revenue	Amount	% of Net Revenue		
Cost of revenue						
Managed Services	\$38,909	63	% \$42,589	65	% \$(3,680)	) (9) %
Cloud and Business Intelligence	3,783	6	% 5,929	9	% (2,146)	) (36) %
Total cost of revenue	\$42,692	69	% \$48,518	74	% \$(5,826)	) (12) %

	Three Months Ended June 30, 2015		2014		Change	% Change
	Amount (in thousand)	Gross Profit %	Amount	Gross Profit %		
Gross profit						

Edgar Filing: SERVICESOURCE INTERNATIONAL, INC. - Form 10-Q

Managed Services	\$ 17,314	28	% \$ 15,986	24	% \$ 1,328	8	%
Cloud and Business Intelligence	1,607	3	% 1,493	2	% 114	8	%
Total gross profit	\$ 18,921	31	% \$ 17,479	26	% \$ 1,442	8	%

27

---

Table of Contents

The \$3.7 million, or 9%, decrease in our cost of revenue for our managed services business in the second quarter of 2015 compared to 2014 reflects a \$3.9 million decrease in compensation expense of managed services personnel, offset by a \$1.4 million increase in temporary labor and a \$1.1 million decrease in allocated overhead as a result of fewer employees driven by customer cancellations.

The \$2.1 million, or 36%, decrease in our cost of revenue for our CBI business in the second quarter of 2015 compared to 2014, reflected a \$1.2 million reduction in compensation expense as a result of lower headcount and a \$0.7 million decrease in temporary labor and consultants, all driven by lower sales.

The increase in managed services gross profit in the second quarter of 2015 was mainly driven by the lower headcount and related personnel costs.

The increase in CBI gross profit in the second quarter of 2015 was due to cost reduction efforts related to less customer implementations of our Renew OnDemand product in the second quarter of 2015.

## Operating Expenses

	Three Months Ended				Change	% Change
	June 30, 2015	% of Net Revenue	2014	% of Net Revenue		
	Amount		Amount			
	(in thousands)					
Operating expenses:						
Sales and marketing	\$10,165	16	% \$17,212	26	% \$(7,047)	) (41)%
Research and development	4,646	8	% 6,881	10	% (2,235)	) (32)%
General and administrative	10,701	17	% 12,256	19	% (1,555)	) (13)%
Restructuring and other	2,988	5	% —	—	% 2,988	100%
Total operating expenses	\$28,500	46	% \$36,349	55	% \$(7,849)	) (22)%
Includes stock-based compensation of:						
Sales and marketing	\$716		\$1,583		\$(867)	)
Research and development	444		736		(292)	)
General and administrative	1,158		1,932		(774)	)
Total stock-based compensation	\$2,318		\$4,251		\$(1,933)	)

## Sales and marketing expenses

The \$7.0 million, or 41%, decrease in sales and marketing expenses in the second quarter of 2015 resulted primarily from lower headcount and the related \$3.8 million decrease in compensation expense. Lower headcount is the result of our efforts to rationalize our cost structure. Also contributing to the decrease was a \$1.7 million decrease in temporary labor and consultant costs, a \$0.6 million decrease in marketing programs, a \$0.3 million decrease in recruiting fees and a \$0.3 million decrease in travel expenses.

## Research and development expenses

The \$2.2 million, or 32%, decrease in research and development expense in the second quarter of 2015 was primarily due to a \$1.4 million decrease in costs related to a decrease in headcount and an \$0.8 million decrease in temporary labor and consulting costs, all related to efforts to reduce the level of research and development spend starting in the second half of 2014.

Internal-use software development capitalization increased by \$1.6 million primarily due to new development efforts on the Customer Lifecycle products. We expect research and development spending to remain flat for the remainder of 2015 and rise more slowly or at the same pace as revenue growth in future years. We expect to capitalize internal-use

software costs in the future and the amount capitalized will depend on the level of new product development.  
General and administrative expenses

28

---

Table of Contents

The \$1.6 million, or 13%, decrease in general and administrative expense in the second quarter of 2015 as compared to the second quarter of 2014 reflected a \$1.6 million decrease in compensation costs, driven by lower headcount and lower stock based compensation expense, and a \$0.4 million decrease in technology spending, offset by a \$1.2 million reduction in overhead allocations to other departments, which is related to lower headcount and information technology spending. Also contributing to the decrease was a \$0.5 million reduction in professional fees.

**Restructuring and other expenses**

The increase in restructuring and other expenses in the second quarter of 2015 is due to a \$3.0 million charge related to employee termination costs. The charge consists primarily of stock based compensation expense related to accelerated vesting of certain equity awards granted to the Company's former interim CFO and CEO, and separation payments.

**Interest expense and other, net**

	Three Months Ended		2014		Change	% Change
	June 30, 2015	% of Net Revenue	Amount	% of Net Revenue		
	Amount		Amount			
	(in thousands)					
Interest expense and other, net	\$2,739	4	% \$2,196	3	% \$543	25 %

Interest expense and other, net increased by \$0.5 million, or 25%, due partially to foreign currency losses in the second quarter of 2015. Interest expense for the second quarter of 2015 as compared to the second quarter of 2014 was slightly higher due to the accretion of debt discount, the amortization of debt issuance costs and interest expense for the convertible notes.

**Income Tax Provision**

	Three Months Ended		Change	% Change
	June 30, 2015	2014		
	(in thousands)			
Income tax provision	\$1,089	\$26	\$1,063	*

\*Not meaningful.

For the second quarter of 2015, we recorded income tax expense of \$1.0 million. The increase to the second quarter tax provision is primarily the result of a recent state tax law change in May 2015. Accordingly, a valuation allowance was recorded to reflect the portion of state deferred tax assets that are more likely than not to be realized. Tax expense for the second quarter also includes the impact to adjust other state deferred tax assets as a result of the state tax law change. The remaining portion of tax expense relates to anticipated taxes in jurisdictions where we have profitable operations, including certain U.S. state and foreign jurisdictions, offset by benefits available from foreign losses. No benefit was provided for losses incurred in the U.S. and Singapore because those losses are offset by a full valuation allowance.

For the second quarter of 2014, we recorded income tax expense of \$0.1 million. This amount primarily represents anticipated taxes in jurisdictions where we have profitable operations, including certain U.S. state and foreign jurisdictions, offset by benefits available from foreign losses. No benefit was provided for losses incurred in U.S. and Singapore because those losses are offset by a full valuation allowance.

Six months ended June 30, 2015 and June 30, 2014

Net Revenue



Table of Contents

	Six Months Ended June 30, 2015		2014		Change	% Change
	Amount (in thousands)	% of Net Revenue	Amount	% of Net Revenue		
Net revenue						
Managed Services	\$114,237	89	% \$117,144	88	% \$(2,907)	(2)%
Cloud and Business Intelligence	13,573	11	% 15,669	12	% (2,096)	(13)%
Total net revenue	\$127,810	100	% \$132,813	100	% \$(5,003)	(4)%

Net revenue decreased \$5.0 million, or 4%, in the six months ended June 30, 2015 compared to the six months ended June 30, 2014. The overall decrease in revenue was due to customer cancellations and reductions in excess of new customer additions in previous quarters. Customer cancellations and reductions in the in the six months ended June 30, 2015 were lower than previous quarters but continue to be slightly more than new business generated. We expect the effects of prior quarters' cancellations and reductions on our revenue to continue through the remainder of 2015. Managed services revenue decreased \$2.9 million, or 2% in the six months ended June 30, 2015 compared to the six months ended June 30, 2014, and was attributable to customer cancellations and reductions in excess of new customer additions in previous quarters.

The \$2.1 million, or 13% decrease in revenue from our Cloud and Business Intelligence ("CBI") in the six months ended June 30, 2015 compared to the six months ended June 30, 2014, was primarily attributable to a loss of subscription revenue related to the elimination of certain services provided to one of our largest customers.

## Cost of Revenue and Gross Profit

	Six Months Ended June 30, 2015		2014		Change	% Change
	Amount (in thousand)	% of Net Revenue	Amount	% of Net Revenue		
Cost of revenue						
Managed Services	\$80,905	63	% \$83,895	63	% \$(2,990)	(4)%
Cloud and Business Intelligence	7,602	6	% 12,218	9	% (4,616)	(38)%
Total cost of revenue	\$88,507	69	% \$96,113	72	% \$(7,606)	(8)%

	Six Months Ended June 30, 2015		2014		Change	% Change
	Amount (in thousand)	Gross Profit %	Amount	Gross Profit %		
Gross profit						
Managed Services	\$33,332	26	% \$33,249	25	% \$83	—%
Cloud and Business Intelligence	5,971	5	% 3,451	3	% 2,520	73%
Total gross profit	\$39,303	31	% \$36,700	28	% \$2,603	7%

The \$3.0 million, or 4%, decrease in our cost of revenue for our managed services business in the six months ended June 30, 2015 compared to the six months ended June 30, 2014 reflects a \$3.5 million decrease in compensation expense of managed services personnel, offset by a \$2.2 million increase in temporary labor, and a \$1.9 million



decrease in allocated overhead as a result of fewer employees driven by customer cancellations.

30

---

Table of Contents

The \$4.6 million, or 38%, decrease in our cost of revenue for our CBI business in the six months ended June 30, 2015 compared to the six months ended June 30, 2014, reflected a \$2.4 million reduction in compensation costs related to lower headcount. Also contributing to the decrease was a \$1.5 million reduction in temporary labor and consultants costs and a \$1.3 million reduction in information technology spending, all driven by lower sales.

Gross profit in the six months ended June 30, 2015 was slightly positive for our managed services business due to lower headcount and related personnel costs.

Gross profit in the six months ended June 30, 2015 increased for our CBI business due to continued focus on cost reductions. Also, contributing to the cost reductions were lower services cost on our new product suite.

## Operating Expenses

	Six Months Ended		2014		Change	% Change
	June 30, 2015	% of Net Revenue	Amount	% of Net Revenue		
	(in thousands)					
Operating expenses:						
Sales and marketing	\$21,000	16	% \$32,883	25	% \$(11,883 )	(36 )%
Research and development	9,468	7	% 13,597	10	% (4,129 )	(30 )%
General and administrative	22,866	18	% 25,121	19	% (2,255 )	(9 )%
Restructuring and other	3,739	3	% —	—	% 3,739	— %
Total operating expenses	\$57,073	44	% \$71,601	54	% \$(14,528 )	(20 )%
Includes stock-based compensation of:						
Sales and marketing	\$1,647		\$3,420		\$(1,773 )	
Research and development	991		1,437		(446 )	
General and administrative	3,411		3,942		(531 )	
Total stock-based compensation	\$6,049		\$8,799		\$(2,750 )	

## Sales and marketing expenses

The \$11.9 million, or 36%, decreased in sales and marketing expenses in the six months ended June 30, 2015 resulted primarily from decreased compensation of \$7.1 million due to lower headcount. The lower headcount period over period is the result of our efforts to rationalize our cost structure. Also contributing to the decrease was a \$2.1 million decrease in temporary labor and consultant costs, a \$1.0 million decrease in travel expenses, a \$0.8 million decrease in marketing programs, a \$0.5 million decrease in overhead allocations and a \$0.4 million decrease in recruiting fees.

## Research and development expenses

The \$4.1 million, or 30% decrease in research and development expense in the six months ended June 30, 2015 was primarily due to a \$2.7 million decreased in compensation expense and a \$1.1 million decrease in temporary labor and consulting costs related to our efforts to reduce research and development spend starting in the second half of 2014. Internal-use software development capitalization increased by \$3.1 million primarily due to new development efforts on the Customer Lifecycle products. We expect research and development spending to remain flat for the remainder of 2015 and rise more slowly or at the same pace as revenue growth in future years. We expect to capitalize internal-use software costs in the future and the amount capitalized will depend on the level of new product development.

## General and administrative expenses

The \$2.3 million, or 9%, decrease in general and administrative expense in the six months ended June 30, 2015 reflected a \$2.1 million decrease in compensation expense related to lower headcount, a \$1.7 million decrease across the following: temporary labor, facilities costs, technology spending, travel, recruiting and depreciation, all offset by a \$2.3 million reduction in overhead allocations to other departments. Also contributing to the decrease was a \$0.6 million reduction in professional fees.



Table of Contents

## Restructuring and other expenses

The increase in restructuring and other expenses in the six months ended June 30, 2015 is related to the Company recognizing additional employee termination related costs of \$3.7 million. The charge consists primarily of stock compensation expense related to the accelerated vesting of certain equity awards granted to the Company's former interim CFO and CEO, and separation payments.

## Interest expense and other, net

	Six Months Ended		2014		Change	% Change
	June 30, 2015	% of Net Revenue	Amount	% of Net Revenue		
	Amount		Amount			
	(in thousands)					
Interest expense and other, net	\$4,584	4	% \$4,770	4	% \$(186 )	(4 )%

Interest expense and other, net decreased by \$0.2 million, or 4%, partially due to foreign currency gains related to the six months ended June 30, 2015, offset by slightly higher interest expense which was due to slightly higher accretion of debt discount, the amortization of debt issuance costs and interest expense related to our convertible notes.

## Income Tax Provision

	Six Months Ended		Change	% Change
	June 30, 2015	2014		
	(in thousands)			
Income tax provision	\$1,223	\$161	\$1,062	*

\*Not meaningful.

For the six months ended June 30, 2015, we recorded a charge to income tax expenses of \$1.2 million. The increase to the second quarter tax provision is primarily the result of a recent state tax law change in May 2015. Accordingly, a valuation allowance was recorded to reflect the portion of the state deferred tax asset that is more likely than not to be realized. Tax expense for the second quarter also includes the adjustment to other state deferred tax assets as a result of the state tax law change. The remaining portion of our tax expense relates to anticipated taxes in jurisdictions where we have profitable operations, including certain U.S. state and foreign jurisdictions, offset by benefits available from foreign losses. No benefit was provided for losses incurred in the U.S. and Singapore because those losses are offset by a full valuation allowance.

For the six months ended June 30, 2014, we recorded a charge to income tax expenses of \$0.2 million. This amount primarily represents anticipated taxes in jurisdictions where we have profitable operations, including certain U.S. states and foreign jurisdictions, offset by limited benefits available from losses in Ireland. No benefit was provided for losses incurred in U.S. and Singapore because those losses are offset by a full valuation allowance.

## Liquidity and Capital Resources

At June 30, 2015, we had cash, cash equivalents and short-term investments of \$214.2 million, which primarily consisted of demand deposits, money market mutual funds, corporate bonds and U.S. government obligations. At June 30, 2015, we had cash and cash equivalents of \$2.3 million held outside of the U.S. by our foreign subsidiaries that was generated by such subsidiaries and which is used to satisfy their current operating requirements. We consider the undistributed earnings of our foreign subsidiaries to be indefinitely reinvested in foreign operations and we do not have current plans to repatriate these earnings to fund our U.S. operations as we have sufficient cash, cash-equivalents and short-term investments held in the U.S.

In August 2013, we issued \$150 million aggregate principal amount of 1.50% convertible notes due August 1, 2018 (the "Notes") and concurrently entered into convertible notes hedges and separate warrant transactions. The Notes will mature on August 1, 2018, unless earlier converted. Upon conversion, the Notes will be settled in cash, shares of our stock, or any combination thereof, at our option. We received proceeds of \$145.6 million from the issuance of the

convertible notes, net of associated fees, received \$21.8 million from the issuance of the warrants and paid \$31.4 million for the note hedges. The Notes

32

---

Table of Contents

were not subject to conversion or repurchase at June 30, 2015 and are classified as a noncurrent liability on our condensed consolidated balance sheet.

Our primary operating cash requirements include the payment of compensation and related costs, working capital requirements related to accounts receivable and accounts payable, as well as costs for our facilities and information technology infrastructure. Historically, we have financed our operations principally from cash provided by our operating activities, proceeds from stock offerings and the exercise of stock options. We believe our existing cash and cash equivalents and short-term investments will be sufficient to meet our working capital and capital expenditure needs for at least the next twelve months. We had no borrowings in 2014 or to date in 2015 from our credit facility.

Credit Facility

On July 5, 2012, the Company, entered into a three-year credit agreement which provides for a secured revolving line of credit based on eligible accounts receivable up to \$30.0 million with a \$2.0 million letter of credit sublimit. On May 5, 2014, we entered into an amendment to the credit agreement which reduced the secured revolving line of credit to \$10.0 million. The quarterly commitment fee, payable in arrears, based on the available commitments is 0.30% per annum. There were no outstanding balances on the facility as of June 30, 2015.

The letter of credit for \$550,000 required under an operating lease agreement for office space at our San Francisco headquarters expired on June 1, 2015. Any outstanding loans under the credit facility bear interest, at our option, at a base rate determined in accordance with the credit agreement, minus 0.5%, or at a LIBOR rate plus 2.0%. Principal, together with all accrued and unpaid interest, was due and payable on July 5, 2015, the maturity date. At June 30, 2015, the interest rate for borrowings under the facility was 2.2%. The credit agreement contains customary affirmative and negative covenants, as well as financial covenants. We were in compliance with all of the covenants under the credit agreement as of June 30, 2015. The credit agreement expired on July 5, 2015.

Summary Cash Flows

The following table sets forth a summary of our cash flows (in thousands):

	Six Months Ended	
	June 30,	
	2015	2014
Net cash (used in) provided by operating activities	\$3,314	\$(92)
Net cash used in investing activities	(16,948)	(57,977)
Net cash provided by financing activities	853	3,357
Net decrease in cash and cash equivalents, net of impact of foreign exchanges on cash	(12,337)	(54,556)

Operating Activities

Net cash provided by operating activities was \$3.3 million during the six months ended June 30, 2015. Net loss during the period was \$23.6 million adjusted by non-cash charges of \$6.8 million for depreciation and amortization, \$3.9 million of amortization of debt discount and issuance costs, \$3.5 million of restructuring and other charges, and \$7.5 million for stock-based compensation. Cash generated from operations during the six months ended June 30, 2015 resulted from sequential changes in our working capital including a \$11.8 million decrease in accounts receivable, a \$2.1 million decrease in accounts payable, a \$1.6 million decrease in accrued compensation and benefits, and a \$2.4 million decrease in accrued expenses.

Net cash provided by operating activities was \$0.1 million during the six months ended June 30, 2014. Net loss during the period was \$39.8 million adjusted by non-cash charges of \$6.3 million for depreciation and amortization, \$10.9 million for stock-based compensation and \$0.4 million of net premiums paid on purchase of short-term investments. Cash used from operations during the six months ended June 30, 2014 resulted from sequential changes in our working capital including a \$15.5 million decrease in accounts receivable, a \$1.0 million decrease in accounts payable and a \$1.9 million increase in accrued compensation and benefits.

Investing Activities

During the six months ended June 30, 2015 cash used in investing activities was principally for the purchases of short-term investments, net of sales and maturities of \$10.6 million, property and equipment addition of \$5.1 million and \$1.2 million



Table of Contents

increase in restricted cash related to a letter of credit required for our new San Francisco facility lease. Property and equipment additions include \$3.1 million of capitalized internal-use software development cost.

During the six months ended June 30, 2014 cash used by investing activities was principally for the purchases of short-term investments, net of sales and maturities of \$19.8 million, the acquisition of Scout Analytics of \$32.5 million and for property and equipment purchases of \$5.6 million.

**Financing Activities**

Cash provided by financing activities of \$0.9 million in the six months ended June 30, 2015 primarily resulted from the exercise of common stock options and the purchase of common stock under our employee stock purchase plan of \$0.9 million.

Cash provided by financing activities was \$3.4 million during the six months ended June 30, 2014 primarily resulted from the exercise of common stock options and the purchase of common stock under our employee stock purchase plan of \$3.6 million offset by payment of capital lease obligations.

**Off-Balance Sheet Arrangements**

We do not have any relationships with other entities or financial partnerships such as entities often referred to as structured finance or special-purpose entities, which have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

**Contractual Obligations and Commitments**

Our principal commitments consist of obligations under operating leases for office space and computer equipment. At June 30, 2015, the future minimum payments under these commitments were as follows (in thousands):

	Total	Less than 1 year	1-3 years	4-5 years	More than 5 years
Obligations under capital leases	\$400	\$183	\$200	\$17	\$—
Operating lease obligations	40,447	7,169	19,181	8,424	5,673
	\$40,847	\$7,352	\$19,381	\$8,441	\$5,673

The contractual commitment amounts in the table above are associated with agreements that are enforceable and legally binding, which specify significant terms including payment terms, related services and the approximate timing of the transaction. Obligations under contracts that we can cancel without a significant penalty are not included in the table above.

Also excluded from the table above is the income tax liability we recorded for the difference between the benefit recognized and measured and the tax position taken or expected to be taken on our tax returns (“unrecognized tax benefits”). As of June 30, 2015, our liability for unrecognized tax benefits was \$0.9 million. Reasonably reliable estimates of the amounts and periods of related future payments cannot be made at this time.

In May 2015 the Company commenced a P7Y-year office lease expiring in November 2022 for a new corporate headquarters in San Francisco, California to occupy 24,394 square feet of space. The table below includes approximately \$13.3 million of minimum lease payments over the P7Y-year lease term.

**Critical Accounting Policies and Estimates**

Management has determined that our most critical accounting policies are those related to revenue recognition, stock-based compensation, debt and marketable securities, goodwill, and income taxes. There have been no material changes in our critical accounting policies and estimates during the three months ended June 30, 2015 as compared to the critical accounting policies and estimates disclosed in “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies and Estimates” of our Annual Report on Form 10-K/A for the year ended December 31, 2014 as filed with the Securities and Exchange Commission on March 17, 2015.

**Recent Accounting Pronouncements**





Table of Contents

The information contained in Note 1 to our condensed consolidated financial statements in Item 1 under the heading, “Recently Adopted Accounting Pronouncements,” is incorporated by reference into this Item 2.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We believe that there have been no significant changes in our market risk exposures for the six months ended June 30, 2015, as compared with those discussed in our Annual Report on Form 10-K/A for the fiscal year ended December 31, 2014.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”) of the end of the period covered by this report (the “Evaluation Date”). In designing and evaluating our disclosure controls and procedures, management recognizes that any disclosure controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Based on management’s evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures are designed to, and are effective to, provide assurance at a reasonable level that the information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosures.

(b) Changes in Internal Control Over Financial Reporting

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during our most recently completed fiscal quarter. Based on that evaluation, our principal executive officer and principal financial officer concluded that there has not been any change in our internal control over financial reporting during the quarter covered by this report that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

On July 8, 2015, a class action securities lawsuit, *Weller v. ServiceSource International, Inc. et al.*, was filed in the U.S. District Court for the Northern District of California (“Weller Lawsuit”) against the Company and Company’s former Chief Executive Officer. The Weller Lawsuit was brought on behalf of purchasers of Company stock during the period January 22, 2014 through May 1, 2014. Plaintiffs allege that the defendants made false and misleading statements about Company’s actual and expected financial performance. Plaintiffs seek unspecified damages. The Company believes that the claims are meritless, and will vigorously defend it.

From time to time, the Company may be subject to other litigation or threatened litigation arising in the ordinary course of our business. Although the results of litigation and claims cannot be predicted with certainty, the Company is currently not aware of any litigation or threats of litigation in which the final outcome could have a material adverse effect on our business, operating results, financial position, or cash flows. Regardless of the outcome, litigation can have an adverse impact on the Company because of defense and settlement costs, diversion of management resources, and other factors. The Company records a contingent liability when it is probable that a loss has been incurred and the amount is reasonably estimable in accordance with accounting for contingencies.

Item 1A. Risk Factors

Investing in our common stock involves a high degree of risk. You should carefully consider the risks described below and the other information in this Quarterly Report on Form 10-Q. If any of the following risks are realized, our business, financial condition, results of operations, cash flows, and the trading price of our common stock could be materially and adversely affected. The risks described below are not the only risks facing us. Risks and uncertainties not currently known to us or that we currently deem to be immaterial may also materially affect our business, financial condition, results of operations, cash flows, and the trading price of our common stock.

Risks Related to Our Business and Industry

Our business and growth depend substantially on customers renewing their agreements with us and expanding their use of our solution for additional available markets. Any decline in our customer renewals, termination of ongoing engagements or failure to expand their relationships with us could harm our future operating results.

In order for us to improve our operating results and grow, it is important that our customers renew their agreements with us when the initial contract term expires and that we expand our customer relationships to add new market opportunities and the related service revenue opportunity under management. Our customers may elect not to renew their contracts with us after their initial terms have expired or may elect to otherwise terminate our services, and we cannot assure you that our customers will renew service contracts with us at the same or higher level of service, if at all, or provide us with the opportunity to manage additional opportunity. Although our renewal rates have been historically higher than those achieved by our customers prior to their using our solution, some customers have still elected not to renew their agreements with us. Our customers’ renewal rates may decline or fluctuate as a result of a number of factors, including their satisfaction or dissatisfaction with our solution and results, our pricing, mergers and acquisitions affecting our customers or their end customers, the effects of economic conditions or reductions in our customers’ or their end customers’ spending levels. If our customers do not renew their agreements with us, renew on less favorable terms, terminate their services with us or fail to contract with us for additional service revenue management opportunities, our revenue may decline and our operating results may be adversely affected.

Our revenue will decline if there is a decrease in the overall demand for our customers’ products and services for which we provide service revenue management.

Our revenue is based on a pay-for-performance model under which we are paid a commission based on the service contracts we sell on behalf of our customers. If a particular customer's products or services fail to appeal to its end customers, our revenue will decline for our work with that customer. In addition, if end customer demand decreases for other reasons, such as negative news regarding our customers or their products, unfavorable economic conditions, shifts in strategy by our customers away from promoting the service contracts we sell in favor of selling their other products or services to their end customers, or if end customers experience financial constraints and terminate or fail to renew the service contracts we sell, we may experience a decrease in our revenue as the demand for our customers' service contracts declines. Similarly, if our

Table of Contents

customers come under economic pressure, they may be more likely to terminate their contracts with us and/or seek to restructure those contracts, and for customers whose contracts are up for renewal, they may seek to renew those contracts on less favorable terms. We have experienced a decline in our opportunity under management from our managed services customers in 2014 as compared to 2013. We expect that the opportunity under management reduction in 2014 will further impact our 2015 results since the Company's 2014 results were not fully impacted within the 2014 calendar year. If we continue to experience such a decline in opportunity under management, our revenue and results of operations will be adversely affected.

If close rates fall short of our estimates, our customer relationships will be at risk, our revenue will suffer and our ability to grow and achieve broader market acceptance of our solution could be harmed.

Given our pay-for-performance pricing model, our revenue is directly tied to close rates. Close rates represent the percentage of the actual opportunity delivered that we renew on behalf of our customers. If the close rate for a particular customer is lower than anticipated, then our revenue for that customer will also be lower than projected. If close rates fall short of expectations across a broad range of customers, or if they fall below expectations for a particularly large customer, then the impact on our revenue and our overall business will be significant. In the event close rates are lower than expected for a given customer, our margins will suffer because we will have already incurred a certain level of costs in both personnel and infrastructure to support the engagement. This risk is compounded by the fact that many of our customer relationships are terminable if we fail to meet certain specified sales targets over a sustained period of time. If actual close rates fall to a level at which our revenue and customer contracts are at risk, then our financial performance will decline and we will be severely compromised in our ability to retain and attract new customers. Increasing our customer base and achieving broader market acceptance of our solution depends, to a large extent, on how effectively our solution increases service sales. As a result, poor performance with respect to our close rates, in addition to causing our revenue, margins and earnings to suffer, will likely damage our customer relationships and overall reputation, and prevent us from effectively developing and maintaining awareness of our brand or achieving widespread acceptance of our solution, in which case we could fail to grow our business and our revenue, margins and earnings would suffer.

The loss of one or more of our key customers could slow our revenue growth or cause our revenue to decline.

A substantial portion of our revenue to date has come from a relatively small number of customers. During the twelve months ended December 31, 2014 and the six months ended June 30, 2015, our top ten customers accounted for 51% and 55% of our revenue, with one customer representing over 9% of our revenue during each of these periods. A relatively small number of customers may continue to account for a significant portion of our revenue for the foreseeable future. The loss of revenue from any of our significant customers for any reason, including the failure to renew our contracts, termination of some or all of our services, a change of relationship with any of our key customers or their acquisition as discussed below, may cause a significant decrease in our revenue.

Our restructuring plans may not produce anticipated benefits and may lead to charges that will adversely affect our results of operations.

We are currently implementing restructuring and other cost-reduction plans designed to reduce our overhead and our operating expenses. As we experience changes in our strategy, we will continue to determine whether additional restructuring efforts are required. These restructuring efforts may result in significant restructuring charges that may adversely affect our results of operations for the periods in which such charges occur. Additionally, actual costs related to such restructuring plans may exceed the amounts that we previously estimated, leading to additional charges as actual costs are incurred. We incurred restructuring and other charges of \$3.7 million in the six months ended June 30, 2015.

We are also going to invest and re-focus our efforts to improve efficiency in our managed services business. These investments and changes will relate to technology, processes, and people. If such changes do not result in the improvements we expect, we could see a decrease in our performance in certain accounts, lower customer satisfaction, and therefore increased customer churn.

Our quarterly results of operations may fluctuate as a result of numerous factors, many of which may be outside of our control.

Our quarterly operating results are likely to fluctuate. Some of the important factors that may cause our revenue, operating results and cash flows to fluctuate from quarter to quarter include:

- our ability to attract new customers;
- our ability to retain existing customers and/or maintain the size of our engagements with those customers;

Table of Contents

the renewal rates we achieve early in an engagement and the time it takes to achieve the close rates expected for the term of the engagement;

our ability to effectively sell and implement our cloud offerings;

fluctuations in the value of end customer contracts delivered to us;

fluctuations in close rates;

changes in our commission rates;

seasonality;

loss of customers for any reason including due to acquisition;

the mix of new customers as compared to existing customers;

the length of the sales cycle for our solution, and our level of upfront investments prior to the period we begin generating revenue associated with such investments;

the timing of customer payments and payment defaults by customers;

the amount and timing of operating costs and capital expenditures related to the operations of our business, including the development of new products or cloud offerings;

the rate of expansion, productivity and realignment of our direct sales force;

the cost and timing of the introduction of new technologies or new services, including additional investments in our cloud offerings;

general economic conditions;

technical difficulties or interruptions in delivery of our solution;

changes in foreign currency exchange rates;

changes in tax rates;

regulatory compliance costs, including data privacy;

costs associated with acquisitions of companies and technologies;

changes in our stock price and the impact of such changes on our convertible notes and related note hedges and warrants;

extraordinary expenses such as litigation or other dispute-related settlement payments; and

the impact of new accounting pronouncements.

Many of the above factors are discussed in more detail elsewhere in these Risk Factors. Many of these factors are outside our control, and the variability and unpredictability of such factors could result in our failing to meet our revenue or operating results expectations for a given period. In addition, the occurrence of one or more of these factors might cause our operating results to vary widely which could lead to negative impacts on our margins, short-term liquidity or ability to retain or attract key personnel, and could cause other unanticipated issues. Accordingly, we believe that quarter-to-quarter comparisons of our revenue, operating results and cash flows may not be meaningful and should not be relied upon as an indication of future performance.

Our customer relationships and overall business will suffer if our cloud offerings do not meet expectations or if we encounter significant problems implementing them for our customers.

In the fall of 2012 we introduced Renew OnDemand, our next-generation service revenue management platform. This platform is offered on a subscription basis and initially served as the core foundation for our customer-facing cloud applications. We have now expanded into other cloud offerings such as ServiceSource Revenue Analytics and ServiceSource Customer Success on the Salesforce platform. Renew OnDemand and our current cloud offerings remains relatively new and we have limited experience selling and/or implementing it for customers, as well as limited experience migrating customers from our traditional platform to Renew OnDemand. Given the complexity and significance of this ongoing transition, including as a result of the amount of customer data within our systems that will need to be accessed and migrated, our customer relationships, our reputation, and our overall business could be severely damaged if our implementations or migrations are poorly executed. In addition, we expect to incur additional expenses as a result of our near term plans to run dual technology platforms as we move toward broad use and

adoption of certain cloud and technologies internally while maintaining our existing technology platform. Similarly our business operations and customer relationships will be at high risk if our cloud offerings do not meet our performance expectations or those of our customers. This could harm our business in numerous ways including, without limitation, a loss of revenue and customer contracts and damage to our reputation.

If we cannot efficiently implement our offering for customers, we may be delayed in generating revenue, fail to generate revenue and/or incur significant costs.

In general, our customer engagements are complex and may require lengthy and significant work to implement our offerings. Changes in our go-to-market and technology strategies also will increase costs and create implementation risks for us. We also have limited experience implementing our current cloud offerings in general. As a result, we generally incur sales



Table of Contents

and marketing expenses related to the commissions owed to our sales representatives and make upfront investments in technology and personnel to support the engagements one to three months before we begin selling end customer contracts. Each customer's situation may be different, and unanticipated difficulties and delays may arise as a result of our failure, or that of our customer, to meet respective implementation responsibilities. If the customer implementation process is not executed successfully or if execution is delayed, we could incur significant costs without yet generating revenue, and our relationships with some of our customers may be adversely impacted.

The market for our solution is relatively undeveloped and may not grow.

The market for service revenue management is still relatively undeveloped, has not yet achieved widespread acceptance and may not grow quickly or at all. In addition, we are still promoting market acceptance of our cloud offerings. Our success will depend to a substantial extent on the willingness of companies to engage a third party such as us to manage the sales of their support, maintenance and subscription contracts and subscribe for our cloud offerings. Many companies have invested substantial personnel, infrastructure and financial resources in their own internal service revenue organizations or in some cases have built or modified software applications to help manage renewals-and therefore may be reluctant to switch to a solution such as ours. Companies may not engage us for other reasons, including a desire to maintain control over all aspects of their sales activities and customer relations, concerns about end customer reaction, a belief that they can sell their support, maintenance and subscription services more cost-effectively using their internal sales organizations, perceptions about the expenses associated with changing to a new approach and the timing of expenses once they adopt a new approach, general reluctance to adopt any new and different approach to old ways of doing business, or other considerations that may not always be evident. New concerns or considerations may also emerge in the future. Particularly because our market is relatively undeveloped, we must address our potential customers' concerns and explain the benefits of our approach in order to convince them to change the way that they manage the sales of support, maintenance and subscription contracts. If companies are not sufficiently convinced that we can address their concerns and that the benefits of our solution are compelling, then the market for our solution may not develop as we anticipate and our business will not grow.

Delayed or unsuccessful investment in new technology, services and markets may harm our financial results.

We plan to invest significant resources in research and development in order to enhance our managed services offerings, and SaaS cloud offerings and other new offerings that will appeal to customers and potential customers. We have undertaken the development of our cloud offerings as our new technology to offer improved and more scalable service revenue management, including enhancements to our applications. In addition, we have continued to develop our cloud offerings to utilize a Salesforce based platform for our solutions. The development of new products and services entails a number of risks that could adversely affect our business and operating results, including:

- the risk of diverting the attention of our management and our employees from the day-to-day operations of the business;
- insufficient revenue to offset increased expenses associated with research, development, operational and marketing activities; and
- write-offs of the value of such technology investments as a result of unsuccessful implementation or otherwise.

If our cloud offerings or any of our other new or modified technology do not work as intended, are not responsive to user preferences or industry or regulatory changes, are not appropriately timed with market opportunity, or are not effectively brought to market, we may lose existing and potential customers or related service revenue opportunities, in which case our results of operations may suffer. The cost of future development of new service revenue management offerings or technologies also could require us to raise additional debt or equity financing. These actions could be dilutive to our stockholders and negatively impact our financial condition or our results of operations.

We sell subscriptions to our cloud offerings separately from our integrated solution, which may not be successful and could impact revenue from our existing solution.

We currently derive a portion of our revenue from subscriptions to our cloud offerings for a few customers, and we package and price the applications we offer on such applications on a subscription model. We may not be able to fully develop a successful market for our subscription applications. In addition, because we have limited prior experience selling technology subscriptions on a stand-alone basis, we may encounter technical and execution challenges that undermine the quality of the technology offering or cause us to fall short of customer expectations. We also have little experience pricing our technology subscriptions separately, which could result in underpricing that damages our profit margins and financial performance. It is also possible that selling a technology solution separately from our integrated solution will result in a reduction in sales of our current offerings that we might otherwise have sold. An unsuccessful expansion of our business to promote a stand-alone

## Table of Contents

subscription model for any of the foregoing reasons or otherwise would lead to a diversion of financial and managerial resources from our existing business and an inability to generate sufficient revenue to offset our investment costs.

We have separated our lines of business and such plan may not produce anticipated benefits and may lead to charges that will adversely affect our results of operations.

We have separated the Cloud & Business Intelligence business unit and the Managed Services unit, though both units still have the same finance, legal, human resources, and high level executive oversight. The establishment of these two separate business units may not be achieved in an efficient manner, and may not fully realize the anticipated growth and costs savings for a variety of reasons. Some of the risks relating to this plan include potential disruption of our operations, diverting management from other important work, failure to obtain anticipated growth rates, a loss of employee morale and productivity, including the effects of employee attrition, and costs relating to such plans exceeding the costs previously estimated.

Our estimates of service revenue opportunity under management and other metrics may prove inaccurate.

We use various estimates in formulating our business plans and analyzing our potential and historical performance, including our estimate of service revenue opportunity under management. We base our estimates upon a number of assumptions that are inherently subject to significant business and economic uncertainties and contingencies, many of which are beyond our control. Our estimates therefore may prove inaccurate.

Recurring revenue opportunity under management (“opportunity under management”) is a forward-looking metric and is our estimate, as of a given date, of the value of all end customer service contracts that we will have the opportunity to sell on behalf of our customers over the subsequent twelve-month period. Opportunity under management is not a measure of our expected revenue. We estimate the value of such end customer contracts based on a combination of factors, including the value of end-customer contracts made available to us by customers in past periods; the minimum value of end-customer contracts that our customers are required to give us the opportunity to sell pursuant to the terms of their contracts with us; periodic internal business reviews of our expectations as to the value of end customer contracts that will be made available to us by customers; the value of end customer contracts included in the SPA; and collaborative discussions with our customers assessing their expectations as to the value of service contracts that they will make available to us for sale. While the minimum value of end customer contracts that our customers are required to give us represents a portion of our estimated opportunity under management, a significant portion of the opportunity under management is estimated based on the other factors described above.

When estimating recurring revenue opportunity under management and other similar metrics, we must, to a large degree, rely on the assumptions described above, which may prove incorrect. These assumptions are inherently subject to significant business and economic uncertainties and contingencies, many of which are beyond our control. Our estimates therefore may prove inaccurate, causing the actual value of end customer contracts delivered to us in a given twelve-month period to differ from our estimate of opportunity under management. These factors include:

- the extent to which customers deliver a greater or lesser value of end customer contracts than may be required or otherwise expected;
- roll-overs of unsold service contract renewals from prior periods to the current period or future periods;
- changes in the pricing or terms of service contracts offered by our customers;
- increases or decreases in the end customer base of our customers;
- the extent to which the renewal rates we achieve on behalf of a customer early in an engagement affect the amount of opportunity that the customer makes available to us later in the engagement;
- customer cancellations of their contracts with us due to acquisitions or otherwise; and
- changes in our customers’ businesses, sales organizations, sales processes or priorities, including changes in executive support for our partnership.

In addition, opportunity under management reflects our estimate for a forward twelve-month period and should not be used to estimate our opportunity for any particular quarter within that period.

If our security measures are breached or fail, resulting in unauthorized access to customer data, our solution may be perceived as insecure, the attractiveness of our solution to current or potential customers may be reduced and we may incur significant liabilities.

Our solution involves the storage and transmission of the proprietary information and protected data that we receive from our customers. We rely on proprietary and commercially available systems, software, tools and monitoring, as well as other processes, to provide security for processing, transmission and storage of such information. If our security measures are

Table of Contents

breached or fail as a result of third-party action, employee negligence, error, malfeasance or otherwise, unauthorized access to customer or end customer data may occur. Improper activities by third parties, advances in computer and software capabilities and encryption technology, new tools and discoveries and other events or developments may facilitate or result in a compromise or breach of our computer systems. Techniques used to obtain unauthorized access or to sabotage systems change frequently and generally are not recognized until launched against a target, and we may be unable to anticipate these techniques or implement adequate protective measures. Our security measures may not be effective in preventing these types of activities, and the security measures of our third-party data centers and service providers may not be adequate.

Our customer contracts generally provide that we will indemnify our customers for data privacy breaches. If such a breach occurs, we could face contractual damages, damages and fees arising from our indemnification obligations, penalties for violation of applicable laws or regulations, possible lawsuits by affected individuals and significant remediation costs and efforts to prevent future occurrences. In addition, whether there is an actual or a perceived breach of our security, the market perception of the effectiveness of our security measures could be harmed significantly and we could lose current or potential customers.

We may be liable to our customers or third parties if we make errors in providing our solution or fail to properly safeguard our customers' confidential information.

The solution we offer is complex, and we make errors from time to time. These may include human errors made in the course of managing the sales process for our customers as we interact with their end customers, or errors arising from our technology solution as it interacts with our customers' systems and the disparate data contained on such systems. Errors may also arise from the launch of and migration of our current offerings to the cloud offerings. The costs incurred in correcting any material errors may be substantial. In addition, as part of our business, we collect, process and analyze confidential information provided by our customers and prospective customers. Although we take significant steps to safeguard the confidentiality of customer information, we could be subject to claims that we disclosed their information without appropriate authorization or used their information inappropriately. Any claims based on errors or unauthorized disclosure or use of information could subject us to exposure for damages, significant legal defense costs, adverse publicity and reputational harm, regardless of the merits or eventual outcome of such claims.

If we are unable to compete effectively against current and future competitors, our business and operating results will be harmed.

The market for service revenue management is evolving. Historically, technology companies have managed their service renewals through internal personnel and relied upon technology ranging from Excel spreadsheets to internally-developed software to customized versions of traditional business intelligence tools and CRM or ERP software from vendors such as Oracle Corporation, SAP AG, Salesforce.com, inc. and NetSuite, Inc. Some companies have made further investments in this area using firms such as Accenture, Plc. and McKinsey & Company, Inc. for technology consulting and education services focused on service renewals. These internally-developed solutions represent the primary alternative to our offerings. We also face direct competition from smaller companies that offer specialized service revenue management solutions, typically providing technology for use by their customers' internal sales personnel. With our acquisition of Scout Analytics in January 2014, we also face competition from other SaaS and enterprise software providers and service providers that offer products and services that analyze recurring revenue management.

We believe the principal competitive factors in our markets include the following:

- recurring revenue industry expertise, best practices, and benchmarks;
- quality and reliability of software offerings, including convenience and efficacy of cloud-based offerings;

- marketing resources and capabilities;
- performance-based pricing of solutions;
- ability to increase recurring revenue, renewal rates, and close rates;
- global capabilities;
- completeness of solution;
- ability to effectively represent customer brands to end customers and channel partners;
- size of upfront investment; and
- size and financial stability of operations.

We believe that more competitors will emerge. With respect to our cloud offerings, we are seeing competition from companies targeting product usage, renewals and customer success related offerings. Competitors may have greater name recognition, longer operating histories, well-established relationships with customers in our markets and substantially greater financial, technical, personnel and other resources than we have, and even a potentially broader array of offerings. Potential

## Table of Contents

competitors of any size may be able to respond more quickly and effectively than we can to new or changing opportunities, technologies, standards or customer or end customer requirements. Even if our solution is more effective than competing solutions, potential customers might choose new entrants unless we can convince them of the advantages of our integrated solution. We expect competition and competitive pressure, from both new and existing competitors, to increase in the future.

If there is a widespread shift away from business customers purchasing maintenance and support service contracts, we could be adversely impacted if we are not able to adapt to new trends or expand our target markets.

As a result of our historical concentration in the software and hardware industries, a significant portion of our revenue comes from the sale of maintenance and support service contracts for the software and hardware products used by our customers' end customers. Although we also sell other types of renewals, such as subscriptions to software-as-a-service offerings, those sales have to date constituted a relatively small portion of our revenue. The emergence of cloud computing and other alternative technology purchasing models, in which technology services are provided on a remote-access basis, may have a significant impact on the size of the market for traditional maintenance and support contracts. If these alternative models continue gaining traction and reduce the size of our traditional market, we will need to continue to adapt our solution to capitalize on these trends or our results of operations will suffer.

Supporting our existing and growing customer base could strain our personnel resources and infrastructure, and if we cannot scale our operations and increase productivity, we may be unsuccessful in implementing our business plan.

Anticipated growth in our customer base will place a strain on our management, administrative, operational and financial infrastructure. We expect that additional investments in sales personnel, information technology, infrastructure and research and development spending will be required to:

- further develop and enhance our offerings;
- address the needs of our customers;
- scale our operations and increase productivity;
- develop new technology; and
- expand our markets and opportunity under management, including into new industry verticals and geographic areas.

Our success will depend in part upon our ability to manage our growth effectively. To do so, we must continue to increase the productivity of our existing employees and to hire, train and manage new employees as needed. To manage domestic and international growth of our operations and personnel, we will need to continue to improve our operational, financial and management controls and our reporting processes and procedures, and implement more extensive and integrated financial and business information systems. These additional investments will increase our operating costs, which will make it more difficult for us to offset any future revenue shortfalls by reducing expenses in the short term. Moreover, if we fail to scale our operations successfully and increase productivity, our overall business will be at risk.

Consolidation in the technology sector is continuing at a rapid pace, which could harm our business in the event that our customers are acquired and their contracts are cancelled.

Consolidation among technology companies in our target market has been robust in recent years, and this trend poses a risk for us. Acquisitions of our customers could lead to cancellation of our contracts with those customers by the acquiring companies and could reduce the number of our existing and potential customers. For example, Oracle has acquired a number of our customers in recent years, including our then-largest customer, Sun Microsystems, in January 2010. Oracle elected to terminate our service contracts with each customer because Oracle conducted its service revenue management internally. If mergers and acquisitions continue, we expect that some of the acquiring

companies, and Oracle in particular, will terminate, renegotiate and/or elect not to renew our contracts with the companies they acquire, which would reduce our revenue.

We enter into long-term, commission-based contracts with our customers, and our failure to correctly price these contracts may negatively affect our profitability.

We enter into long-term contracts with our customers that are priced based on multiple factors determined in large part by the SPA we conduct for our customers. These factors include opportunity size, anticipated close rates and expected commission rates at various levels of sales performance. Some of these factors require forward-looking assumptions that may prove incorrect. If our assumptions are inaccurate, or if we otherwise fail to correctly price our customer contracts, particularly those with lengthy contract terms, then our revenue, profitability and overall business operations may suffer. Further, if we fail to anticipate any unexpected increase in our cost of providing services, including the costs for employees, office space or technology, we could be exposed to risks associated with cost overruns related to our required performance under our contracts, which could have a negative effect on our margins and earnings.



Table of Contents

Many of our customer contracts allow termination for our failure to meet certain performance conditions.

Although most of our customer contracts are subject to multi-year terms, these agreements often have termination rights if we fail to meet specified sales targets. During the SPA and contract negotiation phase with a customer, we typically negotiate minimum performance levels for the engagement. If we fail to meet our required targets and our customers choose to exercise their termination rights, our revenue could decline. These termination rights may also create instability in our revenue forecasts and other forward-looking financial metrics.

Our business may be harmed if our customers rely upon our service revenue forecasts in their business and actual results are materially different.

The contracts that we enter into with our customers provide for sharing of information with respect to forecasts and plans for the renewal of maintenance, support and subscription agreements of our customers. Our customers may use such forecasted data for a variety of purposes related to their business. Our forecasts are based upon the data our customers provide to us, and are inherently subject to significant business, economic and competitive uncertainties, many of which are beyond our control. In addition, these forecasted expectations are based upon historical trends and data that may not be true in subsequent periods. Any material inaccuracies related to these forecasts could lead to claims on the part of our customers related to the accuracy of the forecasted data we provide to them, or the appropriateness of our methodology. Any liability that we incur or any harm to our brand that we suffer because of inaccuracies in the forecasted data we provide to our customers could impact our ability to retain existing customers and harm our business.

Changing global economic conditions and large scale economic shifts may impact our business.

Our overall performance depends in part on worldwide economic conditions that impact the technology sector and other technology-enabled industries such as healthcare, life sciences and industrial systems. For example, the economic downturn typically results in many businesses deferring technology investments, including purchases of new software, hardware and other equipment, and purchases of additional or supplemental maintenance, support and subscription services. To a certain extent, these businesses also slow the rate of renewals of maintenance, support and subscription services for their existing technology base. Any future downturn could cause business customers to stop renewing their existing maintenance, support and subscription agreements or contracting for additional maintenance services as they look for ways to further cut expenses, in which case our business could suffer.

Conversely, a significant upturn in global economic conditions could cause business purchasers to purchase new hardware, software and other technology products, which we generally do not sell, instead of renewing or otherwise purchasing maintenance, support and subscription services for their existing products. A general shift toward new product sales could reduce our near term opportunities for these contracts, which could lead to a decline in our revenue.

Our inability to expand our target markets could adversely impact our business and operating results.

We derive substantially all of our revenue from customers in certain sectors in the technology and technology-enabled healthcare and life sciences industries, and an important part of our strategy is to expand our existing customer base and win new customers in these industries. In addition, because of the service revenue opportunities that we believe exist beyond these industries, we intend to target new customers in additional industry vertical markets, such as technology-enabled building services. In connection with the expansion of our target markets, we may not have familiarity with such additional industry verticals, and our execution of such expansion could face risks where our experience base is less developed within a particular new vertical. We may encounter customers in these previously

untapped markets that have different pricing and other business sensitivities than we are used to managing. As a result of these and other factors, our efforts to expand our solution to additional industry vertical markets may not succeed, may divert management resources from our existing operations and may require us to commit significant financial resources to unproven parts of our business, all of which may harm our financial performance.

A substantial portion of our business consists of supporting our customers' channel partners in the sale of service contracts. If those channel partners become unreceptive to our solution, our business could be harmed.

Many of our customers, including some of our largest customers, sell service contracts through their channel partners and engage our solution to help those channel partners become more effective at selling service contract renewals. These channel partners may have access to some of our cloud offerings in addition to other sales support services we provide. In this context, the ultimate buyers of the service contracts are end customers of those channel partners, who then receive the actual services from our customers. In the event our customers' channel partners become unreceptive to our involvement in the renewals

Table of Contents

process, those channel partners could discourage our current or future customers from engaging our solution to support channel sales. This risk is compounded by the fact that large channel partners may have relationships with more than one of our customers or prospects, in which case the negative reaction of one or more of those large channel partners could impact multiple customer relationships. Accordingly, with respect to those customers and prospective customers who sell service contracts through channel partners, any significant resistance to our solution by their channel partners could harm our ability to attract or retain customers, which would damage our overall business operations.

We face long sales cycles to secure new customer contracts, making it difficult to predict the timing of specific new customer relationships.

We face a variable selling cycle to secure new customer agreements, typically spanning a number of months and requiring our effort to obtain and analyze our prospect's business through the SPA, for which we are not paid. We recently have also experienced a lengthening of our sales cycles reflecting the hiring of a number of new sales personnel in the past eighteen months who are new to selling our solution as well as slower decision making by a few end customers as well as other end customers considering renewals of large, multi-year contracts. This has adversely affected the conversion rates of new customer contracts. Moreover, even if we succeed in developing a relationship with a potential new customer, the scope of the potential subscription or service revenue management engagement frequently changes over the course of the business discussions and, for a variety of reasons, our sales discussions may fail to result in new customer acquisitions. Consequently, we have only a limited ability to predict the timing and size of specific new customer relationships.

If we fail to balance our expenses with our revenue forecasts or experience significant fluctuations in our business, our results could be harmed and we may need to raise additional capital.

Due to our evolving business model, the uncertain size of our markets and the unpredictability of future general economic and financial market conditions, we expect to continue to require significant capital and may not be able to accurately forecast our revenue and operating needs. We require a significant amount of cash resources to operate our business. We plan our expense levels and investments based on estimates of future sales performance for our customers with respect to their end customers, future revenue and future customer acquisition. If our assumptions prove incorrect, we may not be able to adjust our spending quickly enough to offset the resulting decline in growth and revenue. Consequently, we expect that our gross margins, operating margins and cash flows may fluctuate significantly on a quarterly basis, and we may need to raise additional capital in order to meet operating and capital expenditure requirements. Any decline in our customer renewals or termination of our ongoing engagements may result in higher than anticipated losses in the future and shorten the time before we would need to raise additional capital. If we issue equity securities in order to raise additional funds, substantial dilution to existing stockholders may occur. If we raise cash through additional indebtedness, we may be subject to additional contractual restrictions on our business.

If we continue to see turnover of our top executives, or if we are unable to attract, hire, integrate and retain key personnel and other necessary employees, our business will be harmed.

Our future success depends on the continued contributions of our executives, each of whom may be difficult to replace. Our future success also depends in part on our ability to attract, hire, integrate and retain qualified service sales personnel, sales representatives and management-level employees to oversee such sales forces in addition to marketing, research and development and general and administrative personnel to support our global operation. Recently, we have experienced increased turnover in key executive positions, including our chief executive officer and chief financial officer. The loss of any of our key executives, or our inability to continue to attract and retain high-quality talent, could harm our business.

Because competition for our target employees is intense, we may be unable to attract and retain the highly skilled employees we need to support our planned growth.

To continue to execute on our growth plan, we must attract and retain highly qualified sales representatives, engineers and other key employees in the markets in which we have operations. Competition for these personnel is intense, especially for highly educated, qualified sales representatives. We have from time to time in the past experienced, and we expect to continue to experience in the future, difficulty in hiring and retaining highly skilled key employees with appropriate qualifications. In addition, declines in the trading price of our common stock may make attracting and retaining our employees more difficult given the competitive compensatory environment we face recruiting technology employees in the San Francisco Bay Area. If we fail to attract new sales representatives, engineers and other key employees, or fail to retain and motivate our most successful employees, our business and future growth prospects could be harmed.

## Table of Contents

The length of time it takes our newly-hired sales representatives to become productive could adversely impact our success rate, the execution of our overall business plan and our costs.

It can take twelve months or longer before our internal sales representatives are fully trained and productive in selling our solution to prospective customers. This long ramp period presents a number of operational challenges as the cost of recruiting, hiring and carrying new sales representatives cannot be offset by the revenue such new sales representatives produce until after they complete their long ramp periods. Further, given the length of the ramp period, we often cannot determine if a sales representative will succeed until he or she has been employed for a year or more. If we cannot reliably develop our sales representatives to a productive level, or if we lose productive representatives in whom we have heavily invested, our future growth rates and revenue will suffer.

We depend on revenue from sources outside the United States, and our international business operations and expansion plans are subject to risks related to international operations, and may not increase our revenue growth or enhance our business operations.

For the year ended December 31, 2014 and the six months ended June 30, 2015, approximately 35% and 35% of our revenue, respectively, was generated outside of the United States. As a result of our continued focus on international markets, we expect that revenue derived from international sources will continue to represent a significant portion of our total revenue.

A portion of the sales commissions earned from our international customers is paid in foreign currencies. As a result, fluctuations in the value of these foreign currencies may make our solution more expensive or cause resulting fluctuations in cost for international customers, which could harm our business. We currently do not undertake hedging activities to manage these currency fluctuations. In addition, if the effective price of the contracts we sell to end customers were to increase as a result of fluctuations in the exchange rate of the relevant currencies, demand for such contracts could fall, which in turn would reduce our revenue.

Our growth strategy includes further expansion into international markets. Our international expansion may require significant additional financial resources and management attention, and could negatively affect our financial condition, cash flows and operating results. In addition, we may be exposed to associated risks and challenges, including:

- the need to localize and adapt our solution for specific countries, including translation into foreign languages and associated expenses;
- difficulties in staffing and managing foreign operations;
- different pricing environments, longer sales cycles and longer accounts receivable payment cycles and difficulties in collecting accounts receivable;
- new and different sources of competition;
- weaker protection for our intellectual property than in the United States and practical difficulties in enforcing our rights abroad;
- laws and business practices favoring local competitors;
- compliance obligations related to multiple, conflicting and changing foreign governmental laws and regulations, including employment, tax, privacy and data protection laws and regulations;
- increased financial accounting and reporting burdens and complexities;
- restrictions on the transfer of funds;
- adverse tax consequences; and
- unstable regional economic and political conditions.

We cannot assure you we will succeed in creating additional international demand for our solution or that we will be able to effectively sell service agreements in the international markets we enter.

We incur increased costs and demands upon management as a result of complying with the laws and regulations affecting public companies, which could adversely affect our operating results.

As a public company, we incur significant legal, accounting and other expenses, and greater expenditures may be necessary in the future with the advent of new laws, regulations and stock exchange listing requirements pertaining to public companies. The Sarbanes-Oxley Act of 2002 and the Dodd-Frank Act of 2010, as well as rules subsequently implemented by the Securities and Exchange Commission and The NASDAQ Stock Market LLC, impose various requirements on public companies, including establishing effective internal controls and certain corporate governance practices. Our management and other personnel devote a substantial amount of time to these compliance initiatives, and additional laws and regulations may divert further management resources. Moreover, if we are not able to meet new compliance requirements in a timely manner, the market price of our stock could decline, and we could be subject to investigations and other actions by The NASDAQ Stock

Table of Contents

Market LLC, the Securities and Exchange Commission, or other regulatory authorities, which would require additional financial and management resources.

While we believe we currently have adequate internal control over financial reporting, we are required to evaluate our internal control over financial reporting under Section 404 of the Sarbanes-Oxley Act of 2002 and any adverse results from such evaluation could result in a loss of investor confidence in our financial reports and have an adverse effect on our stock price.

Under Section 404 of the Sarbanes-Oxley Act, we are required to furnish a report by our management on our internal control over financial reporting. The report contains, among other matters, an assessment of the effectiveness of our internal control over financial reporting as of the end of our fiscal year, including a statement as to whether or not our internal control over financial reporting is effective. This assessment must include disclosure of any material weaknesses in our internal control over financial reporting identified by management.

We monitor and assess our internal control over financial reporting, and if our management identifies one or more material weaknesses in our internal control over financial reporting and such weakness remains uncorrected at year-end, we will be unable to assert such internal control is effective at such time. If we are unable to assert that our internal control over financial reporting is effective at year-end (or if our independent registered public accounting firm is unable to express an opinion on the effectiveness of our internal control over financial reporting or concludes that we have a material weakness in our internal controls), we could lose investor confidence in the accuracy and completeness of our financial reports, which would likely have an adverse effect on our business and stock price.

Changes in the U.S. and foreign legal and regulatory environment that affect our operations, including those relating to privacy, data security and cross-border data flows, could pose a significant risk to us by disrupting our business and increasing our expenses.

We are subject to a wide variety of laws and regulations in the United States and the other jurisdictions in which we operate, and changes in the level of government regulation of our business have the potential to materially alter our business practices with resultant increases in costs and decreases in profitability. Depending on the jurisdiction, those changes may come about through new legislation, the issuance of new regulations or changes in the interpretation of existing laws and regulations by a court, regulatory body or governmental official. Sometimes those changes have both prospective and retroactive effect, which is particularly true when a change is made through reinterpretation of laws or regulations that have been in effect for some time.

Privacy and data security are rapidly evolving areas of regulation, and additional regulation in those areas, some of it potentially difficult and costly for us to accommodate, is frequently proposed and occasionally adopted. Laws in many countries and jurisdictions, particularly in the European Union and Canada, govern the requirements related to how we store, transfer or otherwise process the private data provided to us by our customers. In addition, the centralized nature of our information systems at the data and operations centers that we use requires the routine flow of data relating to our customers and their respective end customers across national borders, both with respect to the jurisdictions within which we have operations and the jurisdictions in which we provide services to our customers. If this flow of data becomes subject to new or different restrictions, our ability to serve our customers and their respective customers could be seriously impaired for an extended period of time. For example, we participate in the U.S. Department of Commerce Safe Harbor Framework to govern our treatment of data and data flow with respect to our customers and their respective customers across various jurisdictions. We also have entered into various model contracts and related contractual provisions to enable these data flows. For any jurisdictions in which these measures are not recognized or otherwise not compliant with the laws of the countries in which we process data, or where more stringent data privacy laws are enacted irrespective of international treaty arrangements or other existing compliance mechanisms, we could face increased compliance expenses and face penalties for violating such laws or be excluded

from those markets altogether, in which case our operations could be materially damaged.

If we do not adequately protect our intellectual property rights, our competitive position and our business may suffer.

We rely upon a combination of patent, trademark, copyright and trade secret law and contractual terms to protect our intellectual property rights, all of which provide only limited protection. Our success depends, in part, upon our ability to establish, protect and enforce our intellectual property and other proprietary rights. If we fail to protect or effectively enforce our intellectual property rights, others may be able to compete against us using intellectual property that is the same as or similar to our own. In addition, we cannot assure you that our intellectual property rights are sufficient to provide us with a competitive advantage against others who offer services similar to ours.



Table of Contents

While we have filed patent applications to protect our intellectual property, we cannot assure you that any patents will issue or that any issued patents arising from our applications will provide the protection we seek, or that any future patents issued to us will not be challenged, invalidated or circumvented. Also, we cannot assure you that we will obtain any copyright or trademark registrations from our pending or future applications or that any of our trademarks will be enforceable or provide adequate protection of our proprietary rights. We also rely in some circumstances on trade secrets to protect our technology. Trade secrets may lose their value if not properly protected. We endeavor to enter into non-disclosure agreements with our employees, customers, contractors and business partners to limit access to and disclosure of our proprietary information. The steps we have taken, however, may not prevent unauthorized use of our technology, and adequate remedies may not be available in the event of unauthorized use or disclosure of our trade secrets and proprietary technology. However, trade secret protection does not prevent others from reverse engineering or independently developing similar technologies. In addition, reverse engineering, unauthorized copying or other misappropriation of our trade secrets could enable third parties to benefit from our technology without paying for it.

Accordingly, despite our efforts, we may be unable to prevent third parties from infringing or misappropriating our intellectual property and using our technology for their competitive advantage. Any such infringement or misappropriation could have a material adverse effect on our business, results of operations and financial condition. Monitoring infringement of our intellectual property rights can be difficult and costly, and enforcement of our intellectual property rights may require us to bring legal actions against infringers. Infringement actions are inherently uncertain and therefore may not be successful, even when claims are meritorious. Even if such actions are successful, they may require a substantial amount of resources and divert our management's attention.

Claims by others that we infringe or violate their intellectual property could force us to incur significant costs and require us to change the way we conduct our business.

Numerous technology companies including potential competitors protect their intellectual property rights by means such as patents, trade secrets, copyrights and trademarks. We have not conducted an independent review of patents issued to third parties. Additionally, because patent applications in the United States and many other jurisdictions are kept confidential for some period of time before they are published, we may be unaware of pending patent applications that relate to our proprietary technology. From time to time we may receive letters from other parties alleging, or inquiring about, possible breaches of their intellectual property rights.

Any party asserting that we infringe its proprietary rights would force us to defend ourselves, and possibly our customers, against the alleged infringement. The technology industry is characterized by the existence of a large number of patents, copyrights, trademarks and trade secrets and by frequent litigation based on allegations of infringement or other violations of intellectual property rights. Moreover, the risk of such a lawsuit will likely increase as we become larger, the scope of our solution and technology expands and the number of competitors in our market increases. Any such claims or litigation could:

- be time-consuming and expensive to defend, and deplete our financial resources, whether meritorious or not;
- require us to stop providing the services that use the technology that infringes the other party's intellectual property;
- divert the attention of our technical and managerial resources away from our business;
- require us to enter into royalty or licensing agreements with third parties, which may not be available on terms that we deem acceptable, if at all;
- prevent us from operating all or a portion of our business or force us to redesign our technology, which could be difficult and expensive and may make the performance or value of our solution less attractive;
- subject us to significant liability for damages or result in significant settlement payments;
- or
- require us to indemnify our customers as we are required by contract to indemnify some of our customers for certain claims based upon the infringement or alleged infringement of any third party's intellectual property rights resulting

from our customers' use of our intellectual property.

During the course of any intellectual property litigation, confidential information may be disclosed in the form of documents or testimony in connection with discovery requests, depositions or trial testimony. Disclosure of our confidential information and our involvement in intellectual property litigation could harm us. In addition, any uncertainties resulting from the initiation and continuation of any litigation could significantly limit our ability to continue our operations and could harm our relationships with current and prospective customers. Any of the foregoing could disrupt our business and have a material adverse effect on our operating results and financial condition.

In addition, we may incorporate open source software into our technology solution. The terms of many open source licenses have not been interpreted by United States or foreign courts, and there is a risk that such licenses could be construed in a manner that imposes unanticipated conditions or restrictions on our commercialization of any of our solutions that may include open source software. As a result, we will be required to analyze and monitor our use of open source software closely.

## Table of Contents

As a result of the use of open source software, we could be required to seek licenses from third parties in order to develop such future products, re-engineer our products, discontinue sales of our solutions or release our software code under the terms of an open source license to the public. Given the nature of open source software, there is also a risk that third parties may assert copyright and other intellectual property infringement claims against us based on any use of such open source software, as more generally discussed with respect to general intellectual property claims.

Various risks could affect our worldwide operations, including numerous events outside of our control, exposing us to significant costs that could adversely affect our operations and customer confidence.

We conduct operations throughout the world, including our headquarters in the United States and operations in Ireland, Japan, Malaysia, Singapore and the United Kingdom. Such worldwide operations expose us to potential operational disruptions and costs as a result of a wide variety of events, including local inflation or economic downturn, currency exchange fluctuations, political turmoil, labor issues, terrorism, natural disasters and pandemics. Any such disruptions or costs could have a negative effect on our ability to provide our solution or meet our contractual obligations, the cost of our solution, customer satisfaction, our ability to attract or maintain customers, and, ultimately, our profits.

Natural disasters or other catastrophic events may cause damage or disruption to our operations, international commerce and the global economy, and thus could have a strong negative effect on us. Our business operations are subject to interruption by natural disasters, fire, power shortages, pandemics and other events beyond our control. Such events could make it difficult or impossible for us to deliver our solution to our customers, and could decrease demand for our solution. The majority of our research and development activities, corporate headquarters, information technology systems and other critical business operations are located near major seismic faults in the San Francisco Bay Area. Because we may not have insurance coverage that would cover quake-related losses, and significant recovery time could be required to resume operations, our financial condition and operating results could be materially adversely affected in the event of a major earthquake or catastrophic event.

Terrorist attacks and other acts of violence or war may adversely affect worldwide financial markets and could potentially lead to economic recession, which could adversely affect our business, results of operations, financial condition and cash flows. These events could adversely affect our customers' levels of business activity and precipitate sudden significant changes in regional and global economic conditions and cycles.

The technology we currently use may not operate properly, which could damage our reputation, give rise to claims against us or divert application of our resources from other purposes, any of which could harm our business and operating results.

The technology we currently use, which includes our cloud offerings may contain or develop unexpected defects or errors. There can be no assurance that performance problems or defects in our technology will not arise in the future. Errors may result from receipt, entry or interpretation of customer or end customer information or from the interface of our technology with legacy systems and data that are outside of our control. Despite testing, defects or errors may arise in our solution. Any defects and errors that we discover in our technology and any failure by us to identify and effectively address them could result in loss of revenue or market share, liability to customers or others, failure to achieve market acceptance or expansion, diversion of development resources, injury to our reputation, and increased costs. Defects or errors in our technology may discourage existing or potential customers from contracting with us. Correction of defects or errors could prove impossible or impracticable. The costs incurred in correcting any defects or errors or in responding to resulting claims or liability may be substantial and could adversely affect our operating results.

Disruptions in service or damage to the data center that hosts our data and our locations could adversely affect our business.

Our operations depend on our ability to maintain and protect our data servers and cloud applications, which are located in data centers operated for us by third parties. We cannot control or assure the continued or uninterrupted availability of these third-party data centers. In addition, our information technologies and systems, as well as our data center, are vulnerable to damage or interruption from various causes, including natural disasters, war and acts of terrorism and power losses, computer systems failures, Internet and telecommunications or data network failures, operator error, losses of and corruption of data and similar events. Although we conduct business continuity planning and maintain certain insurance for certain events, the situations for which we plan, and the amount of insurance coverage we maintain, may prove inadequate in any particular case. In addition, the occurrence of any of these events could result in interruptions, delays or cessations in the delivery of the solutions we offer to our customers. Any of these events could impair or prohibit our ability to provide our solution, reduce the attractiveness of our solution to current or potential customers and adversely impact our financial condition and results of operations.

## Table of Contents

In addition, despite the implementation of security measures, our infrastructure, data centers, operations and other centers or systems that we interface with, including the Internet and related systems, may be vulnerable to physical intrusions, hackers, improper employee or contractor access, computer viruses, programming errors, denial-of-service attacks or other attacks by third parties.

Any failure or interruptions in the Internet infrastructure, bandwidth providers, data center providers, other third parties or our own systems for providing our solution to customers, and changes in the terms and conditions of third-party platform providers, could negatively impact our business.

Our ability to deliver our solution is dependent on the development and maintenance of the infrastructure of the Internet and other telecommunications services by third parties. Such services include maintenance of a reliable network backbone with the necessary speed, data capacity and security for providing reliable Internet access and services and reliable telecommunications systems that connect our global operations. As we plan to transition to a Salesforce based platform for certain portions of our solutions, we will rely on Salesforce to make application programming interfaces publicly available in order to enable customer integrations with our platform. In addition, any deterioration in our relationship with Salesforce could adversely affect our operating results.

While our solution is designed to operate without interruption, we have experienced and expect that we will in the future experience interruptions and delays in services and availability from time to time. We rely on internal systems as well as third-party vendors, including data center, bandwidth, and telecommunications equipment providers, to provide our solution. We do not maintain redundant systems or facilities for some of these services. In the event of a catastrophic event with respect to one or more of these systems or facilities, we may experience an extended period of system unavailability, which could negatively impact our relationship with our customers.

Additional government regulations may reduce the size of the market for our solution, harm demand for our solution and increase our costs of doing business.

Any changes in government regulations that impact our customers or their end customers could have a harmful effect on our business by reducing the size of our addressable market or otherwise increasing our costs. For example, with respect to our technology-enabled healthcare and life sciences customers, any change in U.S. Food and Drug Administration or foreign equivalent regulation of, or denial, withholding or withdrawal of approval of, our customers' products could lead to a lack of demand for service revenue management with respect to such products. Other changes in government regulations, in areas such as privacy, export compliance or anti-bribery statutes, such as the U.S. Foreign Corrupt Practices Act, could require us to implement changes in our services or operations that increase our cost of doing business and thereby hurt our financial performance.

The future success of our business depends upon the continued use of the Internet as a primary medium for commerce, communication and business applications. Federal, state or foreign government bodies or agencies have in the past adopted, and may in the future adopt, laws or regulations affecting data privacy and the use of the Internet as a commercial medium. In addition, government agencies or private organizations may begin to impose taxes, fees or other charges for accessing the Internet. These laws or charges could limit the growth of Internet-related commerce or communications generally, result in a decline in the use of the Internet and the viability of Internet-based applications such as ours and reduce the demand for our solution.

We operate and offer our services in many jurisdictions and, therefore, may be subject to state, local and foreign taxes that could harm our business.

We operate service sales centers in multiple locations. Some of the jurisdictions in which we operate, such as Ireland, give us the benefit of either relatively low tax rates, tax holidays or government grants, in each case, that are

dependent on how we operate or how many jobs we create and employees we retain. We plan on utilizing such tax incentives in the future as opportunities are made available to us. Any failure on our part to operate in conformity with applicable requirements to remain qualified for any such tax incentives or grants may result in an increase in our taxes. In addition, jurisdictions may choose to increase rates at any time due to economic or other factors, such as the current economic situation in Ireland. Any such rate increases may harm our results of operations.

We may lose sales or incur significant costs should various tax jurisdictions impose taxes on either a broader range of services or services that we have performed in the past. We may be subject to audits of the taxing authorities in the jurisdictions where we do business that would require us to incur costs in responding to such audits. Imposition of such taxes on our services

## Table of Contents

could result in substantial unplanned costs, would effectively increase the cost of such services to our customers and may adversely affect our ability to retain existing customers or to gain new customers in the areas in which such taxes are imposed.

As we acquire companies or technologies in the future, they could prove difficult to integrate, disrupt our business, dilute stockholder value and adversely affect our operating results and the value of our common stock.

As part of our business strategy, we may acquire, enter into joint ventures with, or make investments in companies, services and technologies that we believe to be complementary. Acquisitions and investments involve numerous risks, including:

- difficulties in identifying and acquiring technologies or businesses that will help our business;
- difficulties in integrating operations, technologies, services and personnel;
- diversion of financial and managerial resources from existing operations;
- the risk of entering new markets in which we have little to no experience;
- risks related to the assumption of known and unknown liabilities;
- potential litigation by third parties, such as claims related to intellectual property or other assets acquired or liabilities assumed;
- the risk of write-offs of goodwill and other intangible assets;
- delays in customer engagements due to uncertainty and the inability to maintain relationships with customers of the acquired businesses;
- inability to generate sufficient revenue to offset acquisition or investment costs;
- incurrence of acquisition-related costs;
- harm to our existing business relationships with business partners and customers as a result of the acquisition;
  - the key personnel of the acquired entity or business may decide not to work for us or may not perform according to our expectations; and
- use of substantial portions of our available cash or dilutive issuances of equity securities or the incurrence of debt to consummate the acquisition.

We may record impairment charges related to our acquisitions or strategic investments, such as the goodwill and other intangible asset impairment we recorded in 2014 that was, in part, related to our acquisition of Scout Analytics. In assessing goodwill for impairment, we make significant estimates and assumptions, including estimates and assumptions about market penetration, anticipated growth rates and risk-adjusted discount rates based on our budgets, business plans, economic projections, anticipated future cash flows and industry data. The estimates and assumptions used by management have a high degree of subjectivity and require significant judgment on the part of management. Changes in estimates and assumptions in the context of our impairment testing may have a material impact on us. Any losses or impairment charges that we incur related to acquisitions or strategic investments may have a negative impact on our financial results, and we may continue to incur new or additional losses related to acquisitions or strategic investments that we have not fully impaired or exited.

As a result, if we fail to properly evaluate acquisitions or investments, we may not achieve the anticipated benefits of any such acquisitions, we may incur costs in excess of what we anticipate and management resources and attention may be diverted from other necessary or valuable activities.

We may be exposed to various risks related to legal proceedings or claims that could adversely affect our operating results.

From time to time, we may be party to lawsuits in the normal course of our business. Such litigation may include claims, suits, government investigations and other proceedings involving intellectual property rights, commercial, corporate and securities, labor and employment, wage and hour, and other matters. Litigation in general can be

expensive, lengthy and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict. Responding to lawsuits brought against us, or legal actions initiated by us, can often be expensive and time-consuming. Unfavorable outcomes from any claims and/or lawsuits could adversely affect our business, results of operations, or financial condition, and we could incur substantial monetary liability and/or be required to change our business practices. Our business and technology acquisition activity could also result in litigation in connection with such acquired companies.

#### Risks Relating to Owning Our Common Stock and Capitalization Matters

Our share price has been volatile and is likely to be volatile in the future.

The trading price of our common stock is likely to be highly volatile and could be subject to wide fluctuations in response to various factors. In addition to the risks described in this section, factors that may cause the market price of our common stock to fluctuate include:

50

---



## Table of Contents

fluctuations in our quarterly financial results or the quarterly financial results of companies perceived to be similar to us as discussed in more detail elsewhere in these “Risk Factors”;

failure to achieve our revenue or earnings expectations, or those of investors or analysts, such as we experienced for the second quarter of 2014;

changes in estimates of our financial results or recommendations by securities analysts;

recruitment or departure of key personnel;

investors’ general perception of us;

volatility inherent in prices of technology company stocks;

adverse publicity;

the volume of trading in our common stock, including sales upon exercise of outstanding options;

sales of shares of our common stock by existing stockholders;

regulatory developments in our target markets affecting us, our customers or our competitors;

terrorist attacks or natural disasters or other such events impacting countries where we or our customers have operations; and

actual or perceived changes in general economic, industry and market conditions.

In addition, if the stock market in general experiences a loss of investor confidence, the trading price of our common stock could decline for reasons unrelated to our business, financial condition or results of operations.

Some companies that have had volatile market prices for their securities have had securities class actions filed against them. If a suit were filed against us, regardless of its merits or outcome, it would likely result in substantial costs and divert management’s attention and resources. This could have a material adverse effect on our business, operating results and financial condition.

Our actual results may differ significantly from any guidance that we may issue in the future.

From time to time, we may release financial guidance or other forward-looking statements in our earnings releases, earnings conference calls or otherwise, regarding our future performance that represent our management’s estimates as of the date of release. If given, this guidance will be based on forecasts prepared by our management. These forecasts are not prepared with a view toward compliance with published accounting guidelines, and neither our independent registered public accounting firm nor any other independent expert or outside party compiles or examines the forecasts and, accordingly, no such person expresses any opinion or any other form of assurance with respect to such forecasts. The principal reason that we may release guidance is to provide a basis for our management to discuss our business outlook with analysts and investors. We do not accept any responsibility for any projections or reports published by any third persons. Guidance is necessarily speculative in nature, and it can be expected that some or all of the assumptions of any future guidance furnished by us may not materialize or may vary significantly from actual future results.

Concentration of ownership among our existing executive officers, directors and their affiliates may prevent new investors from influencing significant corporate decisions.

Our directors and executive officers and their affiliates beneficially own, in the aggregate, over 29% of our outstanding common stock as of June 30, 2015. As a result, these stockholders will have substantial influence over all matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, such as a merger or other sale of our company or its assets. This concentration of ownership could limit the ability of other stockholders to influence corporate matters and may have the effect of delaying or preventing a third party from acquiring control over us.

Anti-takeover provisions contained in our certificate of incorporation and bylaws, as well as provisions of Delaware law, could impair a takeover attempt.

Our certificate of incorporation, by laws and Delaware law contain provisions that could have the effect of rendering more difficult or discouraging an acquisition deemed undesirable by our board of directors. Our corporate governance documents include provisions:

- authorizing blank check preferred stock, which could be issued by our board of directors without stockholder approval, with voting, liquidation, dividend and other rights superior to our common stock;
- classifying our board of directors, staggered into three classes, only one of which is elected at each annual meeting;
- limiting the liability of, and providing indemnification to, our directors and officers;
- limiting the ability of our stockholders to call and bring business before special meetings and to take action by written consent in lieu of a meeting;

## Table of Contents

- requiring advance notice of stockholder proposals for business to be conducted at meetings of our stockholders and for nominations of candidates for election to our board of directors;
- controlling the procedures for the conduct and scheduling of stockholder meetings;
- providing the board of directors with the express power to postpone previously scheduled annual meetings and to cancel previously scheduled special meetings;
- limiting the determination of the number of directors on our board and the filling of vacancies or newly created seats on the board to our board of directors then in office; and
- providing that directors may be removed by stockholders only for cause.

These provisions, alone or together, could delay hostile takeovers and changes in control or changes in our management. As a Delaware corporation, we are also subject to provisions of Delaware law, including Section 203 of the Delaware General Corporation law, which limits the ability of stockholders owning in excess of 15% of our outstanding common stock to merge or combine with us.

Any provision of our certificate of incorporation, by laws or Delaware law that has the effect of delaying or deterring a change in control could limit the opportunity for our stockholders to receive a premium for their shares of our common stock, and could also affect the price that some investors are willing to pay for our common stock

Our business could be negatively affected as a result of actions of activist stockholders.

Campaigns by stockholders to effect changes at publicly traded companies are sometimes led by investors seeking to increase short-term stockholder value through various corporate actions. We have recently seen some activist investors take ownership positions in our common stock. Altai Capital Management is the beneficial owner of approximately 14% of our common stock, has a representative on our board and has entered into a letter agreement and registration rights agreement with us governing various rights and obligations. As a general matter, if we become engaged in a proxy contest with an activist stockholder in the future, our business could be adversely affected as such contests could be costly and time consuming, disrupt our operations and divert the attention of management and our employees from executing our strategic plan. Additionally, perceived uncertainties as to our future direction as a result of stockholder activism or changes to the composition of our board of directors may lead to the perception of a change in the direction of our business, instability or lack of continuity which may be exploited by our competitors, cause concern to current or potential buyers and sellers on our platform, and make it more difficult to attract and retain qualified personnel. If buyers and/or sellers choose to delay, defer or reduce transactions with us or through our platform or transact with our competitors instead of us because of any such issues, then our revenue, earnings and operating cash flows could be adversely affected.

If securities or industry analysts do not publish or cease publishing research or reports about us, our business or our market, or if they change their recommendations regarding our stock, our stock price and trading volume could decline.

The trading market for our common stock will depend in part on the research and reports that securities or industry analysts publish about us or our business. If any of these analysts cease coverage of us, the trading price and trading volume of our stock could be negatively impacted. If analysts downgrade our stock or publish unfavorable research about our business, our stock price would also likely decline.

We are leveraged financially, which could adversely affect our ability to adjust our business to respond to competitive pressures and to obtain sufficient funds to satisfy our future growth, business needs and development plans.

We have substantial existing indebtedness. In August 2013, we issued \$150.0 million aggregate principal amount of our convertible notes.

The degree to which we are leveraged could have negative consequences, including, but not limited to, the following: we may be more vulnerable to economic downturns, less able to withstand competitive pressures and less flexible in responding to changing business and economic conditions;

- our ability to obtain additional financing in the future for working capital, capital expenditures, acquisitions, general corporate or other purposes may be limited;
- a substantial portion of our cash flows from operations in the future may be required for the payment of the principal amount of our existing indebtedness when it becomes due; and

we may be required to make cash payments upon any conversion of the convertible notes, which would reduce our cash on hand.

## Table of Contents

A failure to comply with the covenants and other provisions of our debt instruments could result in events of default under such instruments, which could permit acceleration of all of our outstanding convertible notes and credit facilities.

Any required repurchase of the convertible notes as a result of a fundamental change or acceleration of the convertible notes would reduce our cash on hand such that we would not have those funds available for use in our business. If we are at any time unable to generate sufficient cash flows from operations to service our indebtedness when payment is due, we may be required to attempt to renegotiate the terms of the instruments relating to the indebtedness, seek to refinance all or a portion of the indebtedness or obtain additional financing. There can be no assurance that we will be able to successfully renegotiate such terms, that any such refinancing would be possible or that any additional financing could be obtained on terms that are favorable or acceptable to us.

Conversion of our convertible notes will dilute the ownership interest of existing stockholders and may depress the price of our common stock.

The conversion of some or all of our convertible notes will dilute the ownership interests of then-existing stockholders to the extent we deliver shares upon conversion of any of the notes. Any sales in the public market of the common stock issuable upon such conversion could adversely affect prevailing market prices of our common stock. In addition, the existence of the notes may encourage short selling by market participants because the conversion of the notes could be used to satisfy short positions, or anticipated conversion of the notes into shares of our common stock could depress the price of our common stock.

The conditional conversion feature of the notes, if triggered, may adversely affect our financial condition and operating results.

In the event the conditional conversion feature of the notes is triggered, holders of notes will be entitled to convert the notes at any time during specified periods at their option. If one or more holders elect to convert their notes, unless we elect to satisfy our conversion obligation by delivering solely shares of our common stock (other than paying cash in lieu of delivering any fractional share), we would be required to settle a portion of our conversion obligation through the payment of cash, which could adversely affect our liquidity. In addition, even if holders do not elect to convert their notes, we could be required under applicable accounting rules to reclassify all or a portion of the outstanding principal of the notes as a current rather than long term liability, which would result in a material reduction of our net working capital.

The accounting method for convertible debt securities that may be settled in cash, such as the convertible notes, may have a material effect on our reported financial results.

In May 2008, the Financial Accounting Standards Board, which we refer to as FASB, issued FASB Staff Position No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement), which has subsequently been codified as Accounting Standards Codification 470-20, Debt with Conversion and Other Options, which we refer to as ASC 470-20. Under ASC 470-20, an entity must separately account for the liability and equity components of the convertible debt instruments (such as the notes) that may be settled entirely or partially in cash upon conversion in a manner that reflects the issuer's economic interest cost. The effect of ASC 470-20 on the accounting for the notes is that the equity component is included in the additional paid-in capital section of stockholders' equity on our consolidated balance sheet, and the value of the equity component is treated as an original issue discount for purposes of accounting for the debt component of the notes. As a result, we will record a greater amount of non-cash interest expense in current periods presented as a result of the amortization of the discounted carrying value of the notes to their face amount over the term of the notes. We will report lower net income (or greater net loss) in our financial results because ASC 470-20 will require interest to include both the

current period's amortization of the debt discount and the instrument's coupon interest, which could adversely affect our reported or future financial results, the market price of our common stock and the trading price of the notes. In addition, convertible debt instruments (such as the notes) that may be settled entirely or partly in cash are currently accounted for utilizing the treasury stock method, the effect of which is that the shares issuable upon conversion of the notes are not included in the calculation of diluted earnings per share except to the extent that the conversion value of the notes exceeds their principal amount. Under the treasury stock method, the transaction for diluted earnings per share is accounted for as the number of shares of common stock necessary to settle such excess in the principal amount, if we elected to settle such excess in issued shares. We cannot be sure that the accounting standards in the future will continue to permit the use of the treasury stock method. If we are unable to use the treasury stock method in accounting for the shares issuable upon conversion of the notes, then our diluted earnings per share would be adversely affected.

We have incurred and may in the future incur impairments to goodwill or long-lived assets.

Table of Contents

We perform an annual impairment analysis of goodwill in the fourth quarter of each year and between annual tests if events or circumstances indicate that it is more likely than not that the asset is impaired. Negative industry or economic trends, including reduced market prices of our common stock, reduced estimates of future cash flows, disruptions to our business, slower growth rates, or lack of growth in our relevant business units, could lead to impairment charges against our long-lived assets, including goodwill and other intangible assets. During the third quarter of 2014 the value of our common stock declined and we experienced slowing revenue growth, which led us to perform an impairment analysis. Based on the outcome of this analysis, we incurred a goodwill impairment charge of \$21.0 million during the third quarter of 2014 and subsequently in the fourth quarter of 2014, we incurred an additional goodwill impairment charge of \$1.7 million which together eliminated all of the \$22.7 million of goodwill in the CBI segment. During the fourth quarter of 2014, we had a change in strategy for part of the CBI segment which resulted in an impairment charge of \$2.5 million of certain intangible assets from the Scout Analytics acquisition. If in any future period the Company's market capitalization declines, this could indicate a potential impairment, and we may be required to record an impairment charge in that period against any remaining goodwill or other long-live assets.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

None.

Item 6. Exhibits

See the Exhibit Index, which follows the signature page to this report.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SERVICESOURCE INTERNATIONAL, INC.  
(Registrant)

Date: August 7, 2015

By: /s/ ROBERT N. PINKERTON  
Robert N. Pinkerton  
(Principal Financial Officer and Duly Authorized  
Officer)

55

---



Table of Contents

INDEX TO EXHIBITS

Exhibit Number	Description of Document
3.1(1)	Certificate of Incorporation of the Company filed March 24, 2011.
3.2(1)	Bylaws of the Company dated March 24, 2011.
10.1+	Separation Agreement dated as of April 6, 2015 between the Company and Simon Biddiscombe
10.2	Board Resignation Agreement dated as of May 22, 2015 between the Company and Michael Smerklo
31.1	Certification of Principal Executive Officer, pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Financial Officer, pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of Principal Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	Certification of Principal Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	Interactive data files (XBRL) pursuant to Rule 405 of Regulation S-T: (i) the Condensed Consolidated Balance Sheets as of June 30, 2015 and December 31, 2014, (ii) the Condensed Consolidated Statement of Operations for the three and six months ended June 30, 2015 and 2014, (iii) the Condensed Consolidated Statements of Comprehensive Loss for the three and six months ended June 30, 2015 and 2014, (iv) the Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2015 and 2014 and (v) the Notes to Condensed Consolidated Financial Statements. **

(1) Incorporated by reference to the Registrant's Form 8-K filed with the Securities and Exchange Commission on April 1, 2011.

+ Indicates a management contract or compensation plan.

\* In accordance with Item 601(b)(32)(ii) of Regulation S-K and SEC Release No. 33-8238 and 34-47986, Final Rule: Management's Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, the certifications furnished in Exhibits 32.1 and 32.2 hereto are deemed to accompany this Form 10-Q and will not be deemed "filed" for purposes of Section 18 of the Exchange Act. Such certifications will not be deemed to be incorporated by reference into any filings under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

\*\* XBRL (Extensible Business Reporting Language) information is furnished and not filed herewith, is not a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.