

# SERVICESTOURCE INTERNATIONAL, INC.

## FORM 10-Q (Quarterly Report)

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**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 March 31, 2017

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

**SERVICESTOURCE INTERNATIONAL, INC.**

(Exact name of registrant as specified in our charter)

**Delaware**

(State or Other Jurisdiction of  
Incorporation or Organization)

**717 17<sup>th</sup> St., 5<sup>th</sup> Floor  
Denver, CO**

(Address of Principal Executive Offices)

**No. 81-0578975**

(I.R.S. Employer  
Identification No.)

**80202**

(Zip Code)

**(720) 889-8500**

(Registrant's Telephone Number, Including Area Code)

**760 Market Street, 4th Floor, San Francisco, CA 94102**

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input checked="" type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company	<input type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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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	<u>Outstanding as of April 28, 2017</u>
Common Stock	88,610,811

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## PART I. FINANCIAL INFORMATION

Item 1. *Financial Statements*

**SERVICESTOURCE INTERNATIONAL, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(In thousands, except per share amounts)  
(Unaudited)

	March 31, 2017	December 31, 2016
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 50,345	\$ 47,692
Short-term investments	138,701	137,881
Accounts receivable, net	53,190	63,289
Prepaid expenses and other	5,783	7,607
Total current assets	248,019	256,469
Property and equipment, net	38,186	38,180
Deferred income taxes, net of current portion	65	64
Goodwill and intangibles, net	7,554	7,932
Other assets, net	3,447	3,445
Total assets	\$ 297,271	\$ 306,090
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 1,803	\$ 1,916
Accrued taxes	1,051	1,388
Accrued compensation and benefits	17,514	21,579
Deferred revenue	5,286	4,152
Accrued expenses	6,983	5,891
Other current liabilities	1,456	2,958
Total current liabilities	34,093	37,884
Convertible notes, net	137,016	134,775
Other long-term liabilities	7,061	6,495
Total liabilities	178,170	179,154
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Common stock; \$0.0001 par value; 1,000,000 shares authorized; 88,645 shares issued and 88,524 shares outstanding as of March 31, 2017; 88,304 shares issued and 88,183 shares outstanding as of December 31, 2016	8	8
Treasury stock	(441)	(441)
Additional paid-in capital	348,367	344,521
Accumulated deficit	(227,985)	(216,361)
Accumulated other comprehensive income	(848)	(791)
Total stockholders' equity	119,101	126,936
Total liabilities and stockholders' equity	\$ 297,271	\$ 306,090

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

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

	<b>Three Months Ended March 31,</b>	
	<b>2017</b>	<b>2016</b>
Net revenue	\$ 56,708	\$ 59,750
Cost of revenue	41,409	41,434
Gross profit	15,299	18,316
Operating expenses:		
Sales and marketing	8,340	10,454
Research and development	2,243	2,163
General and administrative	13,980	12,043
Total operating expenses	24,563	24,660
Loss from operations	(9,264)	(6,344)
Interest expense and other, net	(2,070)	(1,509)
Loss before income taxes	(11,334)	(7,853)
Income tax provision	290	1,288
Net loss	\$ (11,624)	\$ (9,141)
Net loss per share, basic and diluted	\$ (0.13)	\$ (0.11)
Weighted average common shares outstanding, basic and diluted	88,385	86,081

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

**SERVICESTOURCE INTERNATIONAL, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**  
**(In thousands)**  
**(Unaudited)**

	<u>Three Months Ended March 31,</u>	
	<u>2017</u>	<u>2016</u>
Net loss	\$ (11,624)	\$ (9,141)
Other comprehensive income (loss), net of tax:		
Foreign currency translation adjustments	(130)	765
Unrealized gain on short-term investments, net of tax	73	345
Other comprehensive income (loss), net of tax	(57)	1,110
Total comprehensive loss, net of tax	<u>\$ (11,681)</u>	<u>\$ (8,031)</u>

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

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

	Three Months Ended March 31,	
	2017	2016
<b>Cash flows from operating activities</b>		
Net loss	\$ (11,624)	\$ (9,141)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	4,731	3,737
Amortization of debt discount and issuance costs	2,241	2,103
Accretion of premium on short-term investments	(94)	405
Deferred income taxes	95	1,097
Stock-based compensation	3,218	2,859
Changes in operating assets and liabilities:		
Accounts receivable, net	10,470	2,029
Deferred revenue	1,134	85
Prepaid expenses and other	1,888	1,034
Accounts payable	(104)	1,702
Accrued taxes	(337)	(434)
Accrued compensation and benefits	(4,176)	(4,427)
Accrued expenses	1,021	1,584
Other liabilities	(1,095)	(920)
Net cash provided by operating activities	7,368	1,713
<b>Cash flows from investing activities</b>		
Acquisition of property and equipment	(4,432)	(5,279)
Purchases of short-term investments	(18,059)	(30,999)
Sales of short-term investments	16,513	31,155
Maturities of short-term investments	925	—
Net cash used in investing activities	(5,053)	(5,123)
<b>Cash flows from financing activities</b>		
Repayment on capital leases obligations	(16)	(66)
Repurchase of common stock	—	(7,260)
Proceeds from common stock issuances	616	691
Minimum tax withholding requirement	(131)	(51)
Net cash provided by (used in) financing activities	469	(6,686)
Net increase (decrease) in cash and cash equivalents	2,784	(10,096)
Effect of exchange rate changes on cash and cash equivalents	(131)	(844)
Cash and cash equivalents at beginning of period	47,692	72,334
Cash and cash equivalents at end of period	\$ 50,345	\$ 61,394

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



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 outsourced, performance-based customer success and revenue growth solutions. Through the Company’s people, processes and technology, the Company grows and retain revenue on behalf of its clients - some of the world’s leading business-to-business companies-in more than 35 languages. The Company’s solutions help its clients strengthen their customer relationships, drive improved customer adoption, expansion and retention and minimize churn. The Company’s technology platform and best-practice business processes combined with its highly-trained, client-focused revenue delivery professionals and data from over 15 years of operating experience enable the Company to provide its clients greater value for its customer success services than attained by its clients' in-house customer success teams.

The Company’s pay-for-performance model allows its clients to pay for the services through either flat-rate or variable commissions based on the revenue generated by the Company on their behalf. Fixed-fee arrangements are typically used in quick deployments to address discrete target areas of our clients’ needs. The Company also generates revenue through its professional services teams, who assist clients with data optimization, as well as through supporting select existing clients with the Company’s Renew OnDemand application. The Company’s corporate headquarters is located in Denver, Colorado. The Company has additional U.S. offices in California and Tennessee, and international offices in Bulgaria, Ireland, Japan, Malaysia, Philippines, Singapore and the United Kingdom.

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, 2016 has been derived from the Company’s audited annual consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2016 filed with the Securities and Exchange Commission (“SEC”) on March 6, 2017. 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, 2016, included in our Annual Report on Form 10-K.

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 the Company’s 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.

**Recent Accounting Pronouncements**

In May 2014, the Financial Accounting Standard Board (“FASB”) issued Accounting Standards Update No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” (“ASU 2014-09”) which amended the existing FASB Accounting Standards Codification. Under the new standard, revenue is recognized when a customer obtains control of promised goods or services and is recognized in an amount that reflects the consideration which the entity expects to receive in exchange for those goods or services. The standard also specifies that the incremental costs of obtaining a contract with a customer and the costs of fulfilling a contract with a customer (if those costs are not within the scope of another Topic or Sub-Topic) would be deferred and recognized over the appropriate period of contract performance if they are expected to be recovered. In addition, the standard requires disclosure of the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The FASB recently issued several amendments to the standard, including clarifications on disclosure of prior-period performance obligations and remaining performance obligations.

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The guidance permits two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (modified retrospective method, also known as the cumulative catch-up transition method). The updates are effective for the Company for interim and annual periods beginning after December 15, 2017 and early adoption is permitted for annual periods beginning after December 15, 2016.

The Company continues to assess the impacts of the standard, and has not yet determined whether the standard will have a material impact on our consolidated financial statements. However, we currently believe the most significant impact is from the timing of recognition of sales commission expenses, which upon adoption will be recognized as costs over a period of time instead of immediately. We are also in the process of assessing the impact of the new standard on certain of our contracts that include performance-based fees. We currently recognize such fees in the period when the performance criteria have been met; however, under the new standard we would estimate the variable fees and recognize amounts for which it is probable that a significant reversal would not occur. For certain contracts, this could result in acceleration of recognition of the performance-based fees. We do not currently expect our recurring revenue management fees, based on a fixed percentage of overall sales value associated with the service contracts, to be significantly impacted by the new standard.

We will adopt the standard in the first quarter of 2018 and preliminarily expect to use the modified prospective method. However, we are continuing to evaluate the impact of the standard, and our adoption method is subject to change. We expect to complete our assessment process, including impacts on our processes, systems and financial statement disclosures, by the end of the third quarter of 2017.

In February 2016, the FASB issued ASU No. 2016-02 Leases (Topic 842). This standard requires entities that lease assets to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. The standard is effective for fiscal years and the interim periods within those fiscal years beginning after December 15, 2018. The guidance is required to be applied by the modified retrospective transition approach. Early adoption is permitted. The Company continues to assess the impact of the adoption of this authoritative guidance on its consolidated financial statements.

### **Reclassifications**

Amounts shown in Financing activities - Minimum tax withholding requirement in the Condensed Consolidated Statement of Cash Flows for the three months ended March 31, 2016 have been reclassified from Operating activities - Prepaid expenses and other, to reflect the current period presentation as a result of the adoption of ASU No. 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting, which requires shares withheld for employee taxes to be reclassified from operating activities to financing activities.

### **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. 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 and are available for use in the Company's daily operations. 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 other-than-temporary declines in fair value have 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 months ended March 31, 2017 and 2016 were insignificant.

Cash and cash equivalents and short-term investments consisted of the following as of March 31, 2017 and December 31, 2016 (in thousands):

**March 31, 2017**

	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Cash	\$ 49,835	\$ —	\$ —	\$ 49,835
Cash equivalents:				
Money market mutual funds	510	—	—	510
Total cash and cash equivalents	50,345	—	—	50,345
Short-term investments:				
Corporate bonds	55,010	43	(139)	54,914
U.S. agency securities	34,653	1	(257)	34,397
Asset-backed securities	24,207	12	(27)	24,192
U.S. Treasury securities	25,462	1	(265)	25,198
Total short-term investments	139,332	57	(688)	138,701
Cash, cash equivalents and short-term investments	\$ 189,677	\$ 57	\$ (688)	\$ 189,046

**December 31, 2016**

	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Cash	\$ 47,060	\$ —	\$ —	\$ 47,060
Cash equivalents:				
Money market mutual funds	632	—	—	632
Total cash and cash equivalents	47,692	—	—	47,692
Short-term investments:				
Corporate bonds	54,827	19	(188)	54,658
U.S. agency securities	34,658	—	(281)	34,377
Asset-backed securities	26,431	25	(23)	26,433
U.S. Treasury securities	22,701	—	(288)	22,413
Total short-term investments	138,617	44	(780)	137,881
Cash, cash equivalents and short-term investments	\$ 186,309	\$ 44	\$ (780)	\$ 185,573

The following table summarizes the amortized cost and estimated fair value of money market mutual funds and short-term fixed income securities classified as short-term investments based on stated maturities as of March 31, 2017 (in thousands):

	Amortized Cost	Estimated Fair Value
Less than 1 year	\$ 20,667	\$ 20,656
Due in 1 to 3 years	119,175	118,555
Total	\$ 139,842	\$ 139,211

As of March 31, 2017, 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.

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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 March 31, 2017 and indicates the fair value hierarchy of the valuation (in thousands):

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
<b>Cash equivalents:</b>			
Money market mutual funds	\$ 510	\$ 510	\$ —
Total cash equivalents	510	510	—
<b>Short-term investments:</b>			
Corporate bonds	54,914	—	54,914
U.S. agency securities	34,397	—	34,397
Asset-backed securities	24,192	—	24,192
U.S. Treasury securities	25,198	—	25,198
Total short-term investments	138,701	—	138,701
Cash equivalents and short-term investments	\$ 139,211	\$ 510	\$ 138,701

The Company has restricted cash of \$1.2 million within *Other assets, net* as of March 31, 2017 and December 31, 2016. 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, 2016 and indicates the fair value hierarchy of the valuation (in thousands):

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
<b>Cash equivalents:</b>			
Money market mutual funds	\$ 632	\$ 632	\$ —
Total cash equivalents	632	632	—
<b>Short-term investments:</b>			
Corporate bonds	54,658	—	54,658
U.S. agency securities	34,377	—	34,377
Asset-backed securities	26,433	—	26,433
U.S. Treasury securities	22,413	—	22,413
Total short-term investments	137,881	—	137,881
Cash equivalents and short-term investments	\$ 138,513	\$ 632	\$ 137,881

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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 issuance costs, and are not marked to market each period. The approximate fair value of the convertible notes as of March 31, 2017 and December 31, 2016 was \$144.8 million and \$143.8 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 other financial instruments or long-term debt measured at fair value as of March 31, 2017 and December 31, 2016.

### **Note 4 — Other Assets, Net**

Other assets, net balances were comprised of the following (in thousands):

	March 31, 2017	December 31, 2016
Restricted Cash	\$ 1,244	\$ 1,244
Long-term deposits and other	2,203	2,201
<b>Total</b>	<b>\$ 3,447</b>	<b>\$ 3,445</b>

On February 3, 2015, the Company issued a \$1.2 million letter of credit in connection with a leased facility. The letter of credit is secured by \$1.2 million of a money market account which is classified as restricted cash in other assets, net, in the accompanying condensed consolidated balance sheets.

### **Note 5 — Other Current Liabilities**

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

	March 31, 2017	December 31, 2016
Accrued Interest - Convertible Notes	\$ 375	\$ 938
Deferred Rent	795	1,359
ESPP Withholding	286	661
<b>Total</b>	<b>\$ 1,456</b>	<b>\$ 2,958</b>

### **Note 6 — Debt**

#### **Senior Convertible Notes**

In August 2013, the Company issued senior convertible notes (the “Notes”) in exchange for 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, beginning February 1, 2014.

The Notes are convertible at an initial conversion rate of 61.6770 shares 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 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.

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 scheduled 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, or the holders of at least 25% in principal amount of the outstanding Notes may 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 conversion or repurchase at March 31, 2017.

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 were recorded as a deferred asset in other assets, net, and amortized to interest expense over the term of the Notes. As a result of the adoption of ASU No. 2015-03 in Q1 2016, Simplifying the Presentation of Debt Issuance Cost, these costs were reclassified to Convertible Notes, net, as of December 31, 2016. The transaction costs allocated to the equity component of \$1.3 million were recorded to additional paid-in capital.

The net carrying amount of the liability component of the Notes consists of the following (in thousands):

	<u>March 31, 2017</u>	<u>December 31, 2016</u>
Principal amount	\$ 150,000	\$ 150,000
Unamortized debt discount	(11,878)	(13,928)
Unamortized debt issuance costs	(1,106)	(1,297)
Net carrying amount	<u>\$ 137,016</u>	<u>\$ 134,775</u>

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

	<u>Three Months Ended March 31,</u>	
	<u>2017</u>	<u>2016</u>
Contractual interest expense at 1.5% per annum	\$ 563	\$ 563
Amortization of debt issuance costs	191	179
Accretion of debt discount	2,050	1,924
Total	<u>\$ 2,804</u>	<u>\$ 2,666</u>

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 March 31, 2017 and 2016 was \$2.8 million and \$2.6 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.

### **Litigation**

The Company is subject to various legal proceedings and claims arising in the ordinary course of our business, including the cases discussed below. 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. As of March 31, 2017, the Company has accrued a \$1.5 million reserve relating to our potential liability for currently pending disputes, reflected in *Accrued Expenses* in the accompanying condensed consolidated balance sheets.

On August 23, 2016, the United States District Court for the Middle District of Tennessee granted conditional class certification in a lawsuit originally filed on September 21, 2015 by three former senior sales representatives. The lawsuit, Sarah Patton, et al v. ServiceSource Delaware, Inc., asserts a claim under the Fair Labor Standards Act alleging that certain sales account representatives and senior sales representatives in our Nashville location were not paid for all hours worked and were not properly paid for overtime hours worked. The complaint also asserts claims under Tennessee state law for breach of contract and unjust enrichment; however, the plaintiffs have not yet filed a motion to certify the state law breach of contract and unjust enrichment claims as a class action. The Company will continue to vigorously defend itself against these claims.

## **Note 8 — Share Repurchase Program, Stock-Based Compensation and ESPP**

In August 2015, the Board authorized a stock repurchase program (the "program") with a maximum authorization to repurchase up to \$30.0 million worth of common stock of the Company. The program expires in August 2017. The aggregate amount available under the program was approximately \$19.9 million as of March 31, 2017. The share repurchase program does not obligate the Company to acquire any specific number of shares. Under the program, shares may be repurchased in privately negotiated and/or open market transactions, including under plans complying with Rule 10b5-1 under the Exchange Act. The Company cash settles with the program broker periodically and reflects any unsettled amounts as a current liability at each period end. No shares were repurchased under the program during the quarter ended March 31, 2017.

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

	Three Months Ended March 31,	
	2017	2016
Cost of revenue	\$ 291	\$ 468
Sales and marketing	882	862
Research and development	99	197
General and administrative	1,946	1,332
Total stock-based compensation	<u>\$ 3,218</u>	<u>\$ 2,859</u>

The above table does not include \$0.1 million and \$0.2 million of capitalized stock-based compensation related to internal-use software during the three months ended March 31, 2017 and 2016, respectively.

### ***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. This model requires us to make estimates and assumptions including, among other things, estimates regarding the length of time an employee will retain vested stock options before exercising them, the estimated volatility of our common stock price using peer company volatility and the number of options that will be forfeited prior to vesting. The stock price volatility assumption is determined by examining a blend of the historical volatilities for industry peers and the trading history for the Company's common stock. 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 actual forfeitures during the period 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 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 actual forfeitures during the period is recognized on a straight-line basis over the vesting period.

### ***Equity Incentive Plan***

During the third quarter of 2016, the Company granted performance-based restricted stock unit awards under the Company's 2011 Equity Incentive Plan to certain key executives (the "2016 PSU Awards"). For each 2016 PSU Award, a number of restricted stock units became eligible to vest based on the levels of achievement of the performance-based conditions, and those restricted stock units that became eligible to vest will vest 50% on the first anniversary of the grant date and 50% on the second anniversary of the grant date, except as otherwise provided under certain termination and change-in-control provisions in each award agreement. The aggregate target number of restricted stock units subject to the 2016 PSU Awards was 1.0 million with an aggregate grant date fair value of \$5.1 million. Upon the filing of the Company's 2016 Form 10-K on March 6, 2017, an additional 0.2 million shares with a grant date fair value of \$1.2 million became eligible to vest under the awards. The \$6.3 million grant date fair value is being expensed over the two years vesting term using the accelerated attribution method.

Option and restricted stock activity under the 2011 Equity Incentive Plan for the three months ended March 31, 2017 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
<b>December 31, 2016</b>	10,406	7,495	\$ 4.63	4,643
Additional shares reserved under the 2011 equity incentive plan	3,527	—	—	—
Granted	(190)	67	3.99	123
PSU Additional Goal Shares Achieved	(243)	—	—	243
Options exercised/ Restricted stock released	—	(10)	5.45	(196)
RSU shares withheld for taxes	26	—	—	26
Canceled/Forfeited	215	(156)	6.45	(59)
<b>March 31, 2017</b>	<b>13,741</b>	<b>7,396</b>	<b>\$ 4.58</b>	<b>4,780</b>

The weighted average grant-date fair value of employee stock options granted during the three months ended March 31, 2017 and 2016 was \$2.09 and \$2.08 per share, respectively. The unamortized grant date fair value of both stock options and restricted stock awards totaled \$19.2 million at March 31, 2017.

Potential shares of common stock that are not included in the determination of diluted net loss per share because they are anti-dilutive for the periods presented consist of weighted stock options, non-vested restricted stock and shares to be purchased under our Employee Stock Purchase Plan having an anti-dilutive effect of 3.4 million and 11.3 million shares for the three months ended March 31, 2017 and 2016, respectively.

#### ***Employee Stock Purchase Plan***

The Company's 2011 Employee Stock Purchase Plan (the "ESPP") is intended to qualify under Section 423 of the Internal Revenue Code of 1986. Under the ESPP, employees are eligible to purchase common stock through payroll deductions of up to 10% of their eligible compensation, subject to any plan limitations. The purchase price of the shares on each purchase date is equal to 85% of the lower of the fair market value of the Company's common stock on the first and last trading days of each 12-month offering period.

The ESPP provides that additional shares are reserved under the plan annually on the first day of each fiscal year in an amount equal to the lesser of (i) 1.5 million shares, (ii) one percent of the outstanding shares of common stock on the last day of the immediately preceding fiscal year, or (iii) an amount determined by the board of directors and/or the compensation committee of the board of directors. On January 1, 2017, approximately 0.9 million additional shares were reserved under the ESPP pursuant to the plan's automatic increase provision. As of March 31, 2017, 2.0 million total shares had been issued under the ESPP and 3.8 million shares were available for future issuance.

#### **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 tax years 2010 through 2017 remain subject to examination by federal, state and foreign tax authorities.

For the three months ended March 31, 2017, the Company recorded income tax expense of \$0.3 million. This amount primarily consists of income and withholding taxes for foreign and state jurisdictions where the Company has profitable operations, as well as valuation allowance adjustments for certain U.S. tax jurisdictions. No tax benefit was provided for losses incurred in United States and Singapore because those losses are offset by a full valuation allowance.

The gross amount of the Company's unrecognized tax benefits was \$0.9 million as of March 31, 2017 and December 31, 2016, none of which, if recognized, would affect the Company's effective tax rate.

**Note 10 — Subsequent Events**

During the second quarter of 2017, the Company initiated several strategic changes across the organization intended to better align its cost structure with current business and market conditions, including a headcount reduction and the reduction of office space in two locations. The Company expects to complete the majority of these actions in the second and third quarters of 2017. The Company estimates total one-time costs related to these changes incurred during the second and third quarters of 2017 will be between \$4.5 million and \$5.2 million, including approximately \$1.2 million of non-cash impairment charges for certain leasehold improvements and other property and equipment, approximately \$3.0 million of cash charges relating to employee severance and other benefits and approximately \$0.7 million of cash charges relating to facility lease costs.

## 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 unaudited consolidated financial statements and notes thereto which appear elsewhere in this Quarterly Report on Form 10-Q.

This report, including this MD&A, includes estimates, projections, statements relating to our business plans, objectives, and expected operating results that are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements generally are identified by the words "believe," "project," "expect," "anticipate," "estimate," "intend," "strategy," "future," "opportunity," "plan," "may," "should," "will," "would," "will be," "will continue," "will likely result," and similar expressions. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties that may cause actual results to differ materially. Factors that could cause or contribute to such differences include, but are not limited to, those identified elsewhere in this report and those discussed in the sections of our Annual Report on Form 10-K entitled "Special Note Regarding Forward Looking Statements and Industry Data" and "Risk Factors" and in our other filings with the SEC. 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 or revise publicly any forward-looking statements, whether because of new information, future events, or otherwise.

All dollar amounts expressed as numbers in this MD&A are in millions unless otherwise noted.

### OVERVIEW

ServiceSource International, Inc. is a global leader in outsourced, performance-based customer success and revenue growth solutions. Through our people, processes and technology, we grow and retain revenue on behalf of our clients — some of the world's leading business-to-business companies—in more than 35 languages. Our solutions help our clients strengthen their customer relationships, drive improved customer adoption, expansion and retention and minimize churn. Our technology platform and best-practice business processes combined with our highly-trained, client-focused revenue delivery professionals and data from over 15 years of operating experience enable us to provide our clients greater value for our customer success services than attained by our clients' in-house customer success teams.

### 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 clients. We generally invoice our clients 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 clients 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 to decline in 2017. Subscription fees are accounted for separately from commissions, and they are billed in advance over a monthly, quarterly or annual basis. Subscription revenue is recognized ratably over the related subscription term.

We have generated a significant portion of our revenue from a limited number of clients. Our top ten customers accounted for 67% and 62% of our net revenue for the three months ended March 31, 2017 and 2016, respectively.

The loss of revenue from any of our top clients 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 clients or their acquisition, can cause a significant decrease in our revenue.

Our business is geographically diversified. Through the first three months of 2017, 63% of our net revenue was earned in North America and Latin America ("NALA"), 26% 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 revenue delivery centers in that geography. Predominantly all of the service contracts sold and managed by our revenue delivery centers relate to end customers located in the same geography. APJ is our newest region, and as a result accounts for less of our net revenue. In addition, our Kuala Lumpur, Manila and Sofia locations are revenue delivery centers where we have centralized, for our worldwide operations, the key contract renewal processes that do not require regional expertise, such as client data management and quoting.

### *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 technologies, and allocated overhead costs. Compensation expense 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 client base or Opportunity Under Management expands, we may need to hire additional service sales personnel and invest in infrastructure to support such growth. Our cost of revenue may fluctuate significantly and increase or decrease on an absolute basis and as a percentage of revenue in the near term, including for the reasons discussed under, "Factors Affecting Our Performance—Implementation Cycle" in our 2016 Annual Report on Form 10-K.

### *Operating Expenses*

*Sales and Marketing.* Sales and marketing expenses are a significant component of our operating costs and consist primarily of compensation expenses 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 the contract signing date and twelve to fourteen months following the execution of the applicable contract. When commissions are paid upon contract signing and are not contingent on future payments and continued employment, we consider that portion of the commission to be earned and therefore expensed at contract signing.

*Research and Development.* Research and development expenses consist primarily of employee compensation expense, allocated costs and the cost of third-

party service providers. We focus our research and development efforts on developing new products and applications related to our technology platform. We capitalize certain expenditures related to the development and enhancement of internal-use software related to our technology platform.

*General and Administrative.* General and administrative expenses consist primarily of employee compensation expense 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, which consists of depreciation, amortization of internally developed software, facilities and technology costs.

***Interest Expense and Other, Net***

*Interest expense.* Interest expense consists of interest expense associated with our convertible debt, imputed interest from 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 for the remainder of 2017 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 foreign exchange gains and losses and the interest income earned on our cash, cash equivalents and marketable securities investments. 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 (Benefit)***

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.

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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, and 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. As described in Note 1 of the Notes to the Condensed Consolidated Financial Statements, the results of operations for the periods presented below have been restated to reflect prior period error correction to income tax expense. The period-to-period comparison of financial results presented below is not necessarily indicative of financial results to be achieved in future periods.

	Three Months Ended March 31,	
	2017	2016
	(in thousands)	
Net revenue	\$ 56,708	\$ 59,750
Cost of revenue	41,409	41,434
Gross profit	15,299	18,316
Operating expenses:		
Sales and marketing	8,340	10,454
Research and development	2,243	2,163
General and administrative	13,980	12,043
Total operating expenses	24,563	24,660
Loss from operations	(9,264)	(6,344)
Interest expense and other, net	(2,070)	(1,509)
Loss before income taxes	(11,334)	(7,853)
Income tax provision	290	1,288
Net loss	\$ (11,624)	\$ (9,141)
Includes stock-based compensation of:		
Cost of revenue	\$ 291	\$ 468
Sales and marketing	882	862
Research and development	99	197
General and administrative	1,946	1,332
Total stock-based compensation	\$ 3,218	\$ 2,859

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

	Three Months Ended March 31,	
	2017	2016
	(as % of net revenue)	
Net revenue	100 %	100 %
Cost of revenue	73 %	69 %
Gross profit	27 %	31 %
Operating expenses:		
Sales and marketing	15 %	17 %
Research and development	4 %	4 %
General and administrative	25 %	20 %
Total operating expenses	44 %	41 %
Loss from operations	(17)%	(10)%

### Three Months Ended March 31, 2017 and 2016.

#### *Net Revenue, Cost of Revenue and Gross Profit*

	Three Months Ended March 31,			
	2017	2016	Change	% Change
	(in thousands)			
Net Revenue	\$ 56,708	\$ 59,750	\$ (3,042)	(5)%
Cost of Revenue	41,409	41,434	(25)	— %
Gross Profit	\$ 15,299	\$ 18,316	\$ (3,017)	(16)%

Net revenue decrease d \$3.0 million , or 5% , for the first quarter of 2017 compared to the first quarter of 2016 . The overall decrease was due to contractions and lower production with certain existing customers that was not offset by production related to expansions and new business in the first quarter of 2017 .

Our cost of revenue in the first quarter of 2017 compared to the first quarter of 2016 was flat due mostly to our ramping production with recent new business and the timing of adjusting costs related to the in quarter contractions.

Gross profit in the first quarter of 2017 decrease d by \$3.0 million , or 16% , compared to the same period in 2016 which is consistent with the decrease in revenue.

**Operating Expenses**

	<b>Three Months Ended March 31,</b>			
	<b>2017</b>	<b>2016</b>	<b>Change</b>	<b>% Change</b>
<b>(in thousands)</b>				
<b>Operating expenses:</b>				
Sales and marketing	\$ 8,340	\$ 10,454	\$ (2,114)	(20)%
Research and development	2,243	2,163	80	4 %
General and administrative	13,980	12,043	1,937	16 %
<b>Total operating expenses</b>	<b>\$ 24,563</b>	<b>\$ 24,660</b>	<b>\$ (97)</b>	<b>— %</b>
<b>Includes stock-based compensation of:</b>				
Sales and marketing	\$ 882	\$ 862	\$ 20	
Research and development	99	197	(98)	
General and administrative	1,946	1,332	614	
<b>Total stock-based compensation</b>	<b>\$ 2,927</b>	<b>\$ 2,391</b>	<b>\$ 536</b>	

*Sales and marketing expenses*

The \$2.1 million , or 20% , decrease in sales and marketing expenses in the first quarter of 2017 compared to the first quarter of 2016 resulted from a \$1.5 million decrease in employee related costs, a \$0.5 million decrease in travel costs and a \$0.2 million decrease in overhead allocation. Offsetting this decrease was a \$0.2 million increase in marketing costs.

*Research and development expenses*

The \$0.1 million , or 4% , increase in research and development expense in the first quarter of 2017 compared to the first quarter of 2016 was primarily due to a \$0.3 million decrease in employee related costs associated with higher internal-use software development capitalization rates offset by a \$0.3 million increase in temporary labor and consulting costs and \$0.1 million increase in overhead allocations.

Internal-use software development capitalization increase d by \$0.5 million for the three months ended March 31, 2017 compared to the three months ended March 31, 2016 , primarily due to continued development efforts related to our Renew on Demand and internal managed services platforms.

*General and administrative expenses*

The \$1.9 million , or 16% , increase in general and administrative expense in the first quarter of 2017 compared to the first quarter of 2016 reflected a \$2.0 million increase in employee related costs, \$0.4 million increase in rent and facility expenses, a \$0.4 increase in information technology and \$0.8 million increase in depreciation expense. Offsetting this increase was a \$0.4 million decrease in temp labor and professional fees, a \$0.3 million decrease in travel costs and a \$1.1 million decrease in overhead allocations.

**Interest Expense and Other, Net**

	<b>Three Months Ended March 31,</b>			
	<b>2017</b>	<b>2016</b>	<b>Change</b>	<b>% Change</b>
<b>(in thousands)</b>				
Interest expense	\$ 2,817	\$ 2,681	\$ 136	5 %
Other, net	(747)	(1,172)	(425)	(36)%

Interest expense increase d by \$0.1 million , or 5% , in the first quarter of 2017 compared to the first quarter of 2016 and was due to the increased accretion of debt discount under the effective interest method related to the convertible notes issued in August 2013.

Other, net decrease d by \$0.4 million , or 36% , in the three months ended March 31, 2017 compared to the three months ended March 31, 2016 , primarily due to foreign currency fluctuations.

**Income Tax Provision**

	Three Months Ended March 31,			
	2017	2016	Change	% Change
	(in thousands)			
Income tax provision	\$ 290	\$ 1,288	\$ (998)	*

\*Not considered meaningful.

For the first quarter of 2017, we recorded income tax expense of approximately \$0.3 million. This amount primarily represents anticipated taxes in jurisdictions where we have profitable operations, including certain U.S. states and foreign jurisdictions. Income tax expense decreased in the first quarter 2017 by \$0.9 million compared to the first quarter of 2016 primarily due to a decrease in our valuation allowance related to certain state deferred tax assets. As of March 31, 2017, we have recorded a full valuation allowance on our state deferred tax assets. 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 March 31, 2017, we had cash, cash equivalents and short-term investments of \$ 189.0 million, which primarily consisted of demand deposits, money market mutual funds, corporate bonds and United States government obligations held by well-capitalized financial institutions. In addition, at March 31, 2017, we had cash and cash equivalents of \$7.9 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 United States.

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.

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 converted earlier. Upon conversion, the Notes will be settled in cash, shares of our stock, or any combination thereof, at our option. We received proceeds of \$145.1 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 were not subject to conversion or repurchase at March 31, 2017 and are classified as a noncurrent liability on our condensed consolidated balance sheet.

**Share Repurchase Program**

In August 2015, the Board authorized a stock repurchase program with a maximum authorization repurchase up to \$30.0 million worth of common stock of the Company. The program expires in August 2017. The aggregate amount available under the program was approximately \$19.9 million at March 31, 2017. The program does not obligate the Company to acquire any specific number of shares. Under the program, shares may be repurchased in privately negotiated and/or open market transactions, including under plans complying with Rule 10b5-1 under the Securities Exchange Act of 1934, as amended.

**Letter of Credit and Restricted Cash**

In connection with one of our leased facilities, the Company is required to maintain a \$1.2 million letter of credit. The letter of credit is secured by \$1.2 million of a money market account which is classified as restricted cash in our condensed consolidated balance sheet as of March 31, 2017.



**Summary Cash Flows**

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

	Three Months Ended March 31,	
	2017	2016
Net cash provided by operating activities	\$ 7,368	\$ 1,713
Net cash used in investing activities	(5,053)	(5,123)
Net cash provided (used in) by financing activities	469	(6,686)
Net increase (decrease) in cash and cash equivalents, net of impact of exchange rate changes on cash	2,653	(10,940)

**Operating Activities**

Net cash provided by operating activities was \$7.4 million during the three months ended March 31, 2017. Net loss during the period was \$11.6 million adjusted by non-cash charges of \$4.7 million for depreciation and amortization, \$2.2 million of amortization of debt discount and issuance costs, \$0.1 million for deferred income taxes and \$3.2 million for stock-based compensation. Cash provided by operations as a result of the changes in our working capital include a \$10.5 million decrease in accounts receivable, net, a \$1.1 million increase in deferred revenue, a \$1.9 million decrease in prepaid expenses and other assets and benefits and a \$1.0 million increase in accrued expenses. Uses of cash were related to a \$4.2 million decrease in accrued compensation and a \$1.1 million decrease in other liabilities.

Net cash provided by operating activities was \$1.7 million during the three months ended March 31, 2016. Net loss during the period was \$9.1 million adjusted by non-cash charges of \$3.7 million for depreciation and amortization, \$2.1 million of amortization of debt discount and issuance costs, \$1.1 million for deferred income taxes and \$2.9 million for stock-based compensation. Cash provided by operations as a result of the changes in our working capital include a \$2.0 million decrease in accounts receivable and a \$4.4 million decrease in accrued compensation and benefits. Uses of cash were related to a \$1.6 million increase in accrued expenses and a \$1.7 million increase in accounts payable.

**Investing Activities**

During the three months ended March 31, 2017 cash used in investing activities was principally related to the net purchase, sale and maturities of short-term investments of \$0.6 million and property and equipment additions of \$4.4 million. Property and equipment additions include \$0.1 million of capitalized internal-use software development cost.

During the three months ended March 31, 2016 cash used in investing activities was principally related to the net purchase, sale and maturities of short-term investments of \$0.2 million and property and equipment additions of \$5.3 million. Property and equipment additions include \$3.0 million of capitalized internal-use software development cost.

**Financing Activities**

Cash provided by financing activities of \$0.5 million in the three months ended March 31, 2017 primarily resulted from the exercise of common stock options and the purchase of common stock under our employee stock purchase plan of \$0.6 million.

Cash used in financing activities of \$6.7 million in the three months ended March 31, 2016 primarily resulted from the \$7.3 million repurchase of common stock offset by the exercise of common stock options and the purchase of common stock under our employee stock purchase plan of \$0.7 million.

**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**

There have been no material changes in our contractual obligations and commercial commitments other than in the ordinary course of business since the end of fiscal 2016.

## **Critical Accounting Policies and Estimates**

Management has determined that our most critical accounting policies are those related to revenue recognition, stock-based compensation, goodwill and intangible assets and income taxes. There have been no material changes in our critical accounting policies and estimates during the three months ended March 31, 2017 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 for the year ended December 31, 2016 as filed with the Securities and Exchange Commission on March 6, 2017 except as described below.

We estimate the fair value of stock options granted using the Black-Scholes option-pricing model. This model requires us to make estimates and assumptions including, among other things, estimates regarding the length of time an employee will retain vested stock options before exercising them and the estimated volatility of our common stock price. The stock price volatility assumption is determined by examining a blend of the historical volatilities for industry peers and the trading history for the Company’s common stock. Additionally, as a result of our early adoption of ASU 2016-09 in the third quarter of 2016 on a modified retrospective basis, estimation of equity award forfeitures was eliminated, and forfeitures are recognized as they occur.

## **Recent Accounting Pronouncements**

The information contained in Note 1 to our condensed consolidated financial statements in Item 1 under the heading, “Recent 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 three months ended March 31, 2017, as compared with those discussed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016.

## **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**

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.

**PART II. OTHER INFORMATION**

**Item 1. *Legal Proceedings***

For a discussion of legal proceedings in which we are involved, see Note 7 to our condensed consolidated financial statements appearing elsewhere in this Quarterly Report on Form 10-Q.

**ITEM 1A. *Risk Factors***

A summary of factors which could affect results and cause results to differ materially from those expressed in any forward-looking statements made by us, or on our behalf, are further described under the caption "Risk Factors" in the Business portion of our 2016 Annual Report on Form 10-K. There have been no material changes in the nature of these factors since December 31, 2016.

**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.

**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.

SERVICESTRONG INTERNATIONAL, INC.  
(Registrant)

Date: May 8, 2017

By: /s/ ROBERT N. PINKERTON

Robert N. Pinkerton  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

INDEX TO EXHIBITS

<b><u>Exhibit Number</u></b>	<b><u>Description of Document</u></b>
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 March 31, 2017 and December 31, 2016, (ii) the Condensed Consolidated Statement of Operations for the three months ended March 31, 2017 and 2016, (iii) the Condensed Consolidated Statements of Comprehensive Loss for the three months ended March 31, 2017 and 2016, (iv) the Condensed Consolidated Statements of Cash Flows for the three months ended March 31, 2017 and 2016 and (v) the Notes to Condensed Consolidated Financial Statements.

\* Furnished herewith.

**CERTIFICATION PURSUANT TO RULE 13A-14(A) AND RULE 15D-14(A)  
OF THE SECURITIES EXCHANGE ACT OF 1934,  
AS ADOPTED PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Christopher M. Carrington, certify that:

1. I have reviewed this quarterly report on Form 10-Q of ServiceSource International, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: May 8, 2017

By:           /s/ CHRISTOPHER M. CARRINGTON          

Name: Christopher M. Carrington

Title: Chief Executive Officer

**CERTIFICATION PURSUANT TO RULE 13A-14(A) AND RULE 15D-14(A)  
OF THE SECURITIES EXCHANGE ACT OF 1934,  
AS ADOPTED PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Robert N. Pinkerton, certify that:

1. I have reviewed this quarterly report on Form 10-Q of ServiceSource International, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: May 8, 2017

By: /s/ ROBERT N. PINKERTON

Name: Robert N. Pinkerton

Title: Chief Financial Officer

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Based on my knowledge, I, Christopher M. Carrington, certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of ServiceSource International, Inc. on Form 10-Q for the quarter ended March 31, 2017, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and that information contained in such Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of ServiceSource International, Inc.

Date: May 8, 2017

By: /s/ CHRISTOPHER M. CARRINGTON

Name: Christopher M. Carrington

Title: Chief Executive Officer



**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Based on my knowledge, I, Robert N. Pinkerton, certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of ServiceSource International, Inc. on Form 10-Q for the quarter ended March 31, 2017, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and that information contained in such Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of ServiceSource International, Inc.

Date: May 8, 2017

By: /s/ ROBERT N. PINKERTON

Name: Robert N. Pinkerton

Title: Chief Financial Officer