

# Q2 2018 Earnings Call

August 6, 2018

# Important Information

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- This presentation contains forward-looking statements that involve risks, uncertainties and assumptions, including guidance, projections, and estimates of future financial condition and results of operations. If the risks or uncertainties materialize or the assumptions prove incorrect, our results may differ materially from those expressed or implied by such forward-looking statements. Typically, these statements contain words such as “if,” “believe,” “may,” “will,” “estimate,” “continue,” “anticipate,” “intend,” “expect,” and similar expressions.
- The forward-looking statements in this presentation are based on estimates and information available to us at the time of this presentation. These statements are subject to risks and uncertainties that could cause actual results and events to differ materially and are not guarantees of future performance. Except as required by law, we undertake no obligation to update the forward-looking statements to reflect subsequent events or circumstances. A detailed discussion of these and other risks and uncertainties that could cause actual results and events to differ materially from such forward-looking statements is included in our Report on Form 10-K for the 2017 fiscal year end and our other periodic reports filed with the Securities and Exchange Commission, which can be accessed at <http://www.sec.gov>.
- This presentation refers to certain non-GAAP financial metrics. See the GAAP to non-GAAP reconciliation tables contained in this presentation and our earnings press release posted on the Investor Relations portion of the ServiceSource website for a reconciliation of the non-GAAP metrics to the closest GAAP financial measures.

# Q2'18 Non-GAAP Operating Expenses

## Non-GAAP

In \$ millions except EPS

	Q2 2018	Q2 2017
Cost of Revenue*	\$ 39.4	\$ 36.0
% of Revenue	64.4%	61.8%
Sales & Marketing*	8.0	7.5
% of revenue	13%	13%
Research & Development*	1.7	1.2
% of revenue	3%	2%
General & Administration*	10.7	10.7
% of revenue	18%	18%
Total Expenses*	59.8	55.4
% of revenue	98%	95%
Adjusted EBITDA*	\$ 3.2	\$ 4.7
% of revenue	5%	-8%
Non-GAAP Net Income*	0.8	1.5
Non-GAAP EPS*	0.01	0.02
Shares used in calculating basic net Income (in the millions)	91.3	88.8

Please Refer to Appendix for GAAP  
to Non GAAP Reconciliations

\* Financials are Non-GAAP and exclude, where appropriate, stock-based compensation expense, amortization of internally developed software and purchased intangibles, restructuring and other costs, impairment loss on investment securities, amortization of contract acquisition costs related to the initial adoption of Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASC 606") and non-cash expenses relating to the convertible note.

# Q3'18 Guidance – Key Metrics\*

## Q3'18 Guidance

Please Refer to Appendix for GAAP to Non GAAP Reconciliations

In \$ millions except EPS	Q3 Low	Q3 High
Revenue Range	\$ 60.0	\$ 61.0
<i>y/y growth</i>	3.2%	4.7%
Adjusted EBITDA*	\$ 3.5	\$ 4.5
Non-GAAP Net Income*	\$ 1.00	\$ 2.00
Non-GAAP EPS*	\$ 0.01	\$ 0.02

\* Financials are Non-GAAP and exclude, where appropriate, stock-based compensation expense, amortization of internally developed software and purchased intangibles, restructuring and other costs, impairment loss on investment securities, amortization of contract acquisition costs related to the initial adoption of ASC 606, and non-cash expenses relating to the convertible note.

# FY'18 Guidance – Key Metrics\*

## FY'18 Guidance

In \$ millions except EPS

FY Low

FY High

Please Refer to Appendix for GAAP to Non GAAP Reconciliations

Revenue Range

\$ 246.0

\$ 249.0

*y/y growth*

2.9%

4.1%

Gross Margin\*

36.5%

37.5%

Operating Expense (% of revenue)

32.0%

32.5%

Adjusted EBITDA\*

\$ 19.0

\$ 22.0

Non-GAAP Net Income\*

\$ 8.0

\$ 10.0

Non-GAAP EPS

\$ 0.09

\$ 0.11

Free Cash Flow \*\*

\$ 0.0

\$ 3.0

\* Financials are Non-GAAP and exclude, where appropriate, stock-based compensation expense, amortization of internally developed software and purchased intangibles, restructuring and other costs, impairment loss on investment securities, amortization of contract acquisition costs related to the initial adoption of ASC 606, and non-cash expenses relating to the convertible note

\*\* Excludes restructuring and other costs

# Appendix

# Q2'18 GAAP to Non-GAAP Operating Expense

## GAAP to Non-GAAP Reconciliation

(In thousands)

(Unaudited)

		<b>Three Months Ended June 30, 2018</b>
GAAP operating expenses		\$ 24,345
Non-GAAP adjustments:		
Stock-based compensation	( A )	(3,148)
Amortization of internally-developed software	( B )	(214)
Amortization of purchased intangible assets	( C )	-
Restructuring and other costs	( D )	(156)
Amortization of contract acquisition costs - ASC 606 initial adoption	( F )	(420)
Non-GAAP operating expense		\$ 20,407

# Q3'18 Guidance GAAP to Non-GAAP Reconciliation Tables



# Q3'18 Guidance GAAP to Non-GAAP–Net Loss & EPS

## GAAP to Non-GAAP Reconciliation

(In thousands, except per share data)

(Unaudited)

	Three Months Ended September 30, 2018		Three Months Ended September 30, 2018
GAAP net loss	(\$4,100) - (\$3,100)	GAAP diluted net loss per share	(\$0.04) - (\$0.03)
Non-GAAP adjustments:		Non-GAAP adjustments:	
Stock-based compensation (A)	3,400	Stock-based compensation (A)	0.04
Amortization of internally-developed software (B)	1,700	Amortization of internally-developed software (B)	0.02
Amortization of purchased intangible assets (C)	-	Amortization of purchased intangible assets (C)	-
Amortization of contract acquisition costs - ASC 606 initial adoption (F)	300	Amortization of contract acquisition costs - ASC 606 initial adoption (F)	0.00
Non-cash interest expense (G)	900	Non-cash interest expense (G)	0.01
Income tax effect on non-GAAP adjustments and impact of normalizing the effective income tax rate (H)	(\$1,200) - (\$1,200)	Income tax effect on non-GAAP adjustments and impact of normalizing the effective income tax rate (H)	(\$0.01) - (\$0.01)
Non-GAAP net income	\$1,000 - \$2,000	Non-GAAP diluted net (loss) income per share (I)	\$0.01 - \$0.02
		<i>Certain totals may not add due to rounding</i>	
		Shares used in calculating diluted net (loss) income per share on a non-GAAP basis	91,373

# Q3'18 Guidance Net Loss to EBITDA

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## Reconciliation of Net Loss to Adjusted EBITDA

(In thousands)

(Unaudited)

		<b>Three Months Ended September 30, 2018</b>
Net loss range		(\$4,100) - (\$3,100)
Income tax (benefit) provision		300
Interest & other expense, net		-
Depreciation & Amortization		3,600
EBITDA range		(\$200) - \$800
Stock-based compensation	( A )	3,400
Amortization of contract acquisition costs - ASC 606 initial adoption	( F )	300
Adjusted EBITDA range		\$3,500 - \$4,500

# FY'18 Guidance GAAP to Non-GAAP Reconciliation Tables

# FY'18 Guidance GAAP to Non-GAAP – Gross Margin

## GROSS MARGIN - GAAP TO NON-GAAP RECONCILIATION

(In thousands)

(Unaudited)

		Twelve Months Ended December 31, <u>2018</u>
GAAP Gross Profit		\$81,000 - \$84,600
Non-GAAP adjustments:		
Stock-based compensation	( A )	1,300
Amortization of internally-developed software	( B )	7,400
Amortization of purchased intangible assets	( C )	100
Non-GAAP Gross Profit		<u>\$89,800 - \$93,400</u>
GAAP Gross Margin		<u>33.0% - 34.0%</u>
Non-GAAP adjustments:		
Stock-based compensation	( A )	1%
Amortization of internally-developed software	( B )	3%
Amortization of purchased intangible assets	( C )	0%
Non-GAAP Gross Margin		<u>36.5% - 37.5%</u>
<i>Certain totals may not add due to rounding</i>		

# FY'18 Guidance GAAP to Non-GAAP–Net Loss & EPS

## GAAP to Non-GAAP Reconciliation

(In thousands, except per share data)

(Unaudited)

	Twelve Months Ended December 31, 2018		Twelve Months Ended December 31, 2018
GAAP net loss	(\$21,800) - (\$18,800)	GAAP diluted net loss per share	(\$0.24) - (\$0.20)
Non-GAAP adjustments:		Non-GAAP adjustments:	
Stock-based compensation (A)	13,100	Stock-based compensation (A)	0.14
Amortization of internally-developed software (B)	8,600	Amortization of internally-developed software (B)	0.09
Amortization of purchased intangible assets (C)	100	Amortization of purchased intangible assets (C)	0.00
Restructuring and other costs (D)	200	Restructuring and other costs (D)	0.00
Impairment loss on investment securities (E)	2,000	Impairment loss on investment securities (E)	0.02
Amortization of contract acquisition costs - ASC 606 initial adoption (F)	1,500	Amortization of contract acquisition costs - ASC 606 initial adoption (F)	0.02
Non-cash interest expense (G)	5,800	Non-cash interest expense (G)	0.06
Income tax effect on non-GAAP adjustments and impact of normalizing the effective income tax rate (H)	(\$1,500) - (\$2,500)	Income tax effect on non-GAAP adjustments and impact of normalizing the effective income tax rate (H)	(0.02) - (0.03)
Non-GAAP net income	\$8,000 - \$10,000	Non-GAAP diluted net (loss) income per share (I)	\$0.09 - \$0.11
		<i>Certain totals may not add due to rounding</i>	
		Shares used in calculating diluted net income per share on a non-GAAP basis	91,821

# FY'18 Guidance Net Loss to EBITDA

## Reconciliation of Net Loss to Adjusted EBITDA

(In thousands)

(Unaudited)

	<b>Twelve Months Ended December 31, 2018</b>
Net loss range	(\$21,800) - (\$18,800)
Income tax (benefit) provision	800
Interest & other expense, net	7,100
Depreciation & Amortization	16,100
EBITDA range	\$2,200 - \$5,200
Stock-based compensation ( A )	13,100
Restructuring and other costs ( D )	200
Impairment of investment securities ( E )	2,000
Amortization of contract acquisition costs - ASC 606 initial adoption ( F )	1,500
Adjusted EBITDA range	\$19,000 - \$22,000

# FY'18 Guidance Cash Flow from Operations to Free Cash Flow

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## Supplemental Cash Flow Information Free cash flow analysis, a Non-GAAP measure

(In thousands) (Unaudited)	Twelve Months Ended December 31, <u>2018</u>
Net cash provided by operating activities	\$14,000 - \$20,000
Less:	
Capital expenditures	\$14,000 - \$17,000
FX adjustment	-
Free cash flow	<u>\$0 - \$3,000</u>

# Footnotes

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- (A) **Stock-based compensation.** Included in our GAAP presentation of cost of revenue and operating expenses, stock-based compensation consists of expenses for stock options and awards and purchase rights under our stock purchase plan. We exclude stock-based compensation expense from our non-GAAP measures because some investors may view it as not reflective of our core operating performance as it is a non-cash expense.
- (B) **Amortization of internally-developed software.** Included in our GAAP presentation of cost of revenue and operating expenses, amortization of internally-developed software reflects non-cash expense for certain software purchases and software developed or obtained for internal use. We exclude these expenses from our non-GAAP measures because we believe they are not indicative of our core operating performance.
- (C) **Amortization of Purchased Intangibles.** Included in our GAAP presentation of gross margin and operating expenses is amortization of purchased intangible assets. We believe amortization of acquisition-related intangible assets, such as the amortization of the cost associated with an acquired company's research and development efforts, trade names and customer relationships, are items arising from pre-acquisition activities and therefore are properly determined at the time of an acquisition. Although these intangible assets are continually evaluated for impairment, amortization of the cost of purchased intangibles is a static expense, one that is not typically affected by operations during any particular period.
- (D) **Restructuring and other costs.** Included in our GAAP presentation are expenses associated with our announced restructuring effort, commencing in Q2 2017. Restructuring and other costs consist of: employee severance and other benefits, costs of write-off of leasehold improvements, other property, equipment, and other lease exit costs. These are one-time in nature costs that are not indicative of our core operating performance.
- (E) **Impairment loss on investment securities.** Included in our GAAP presentation, this impairment of available-for-sale investment securities is equal to the difference between the fair value and amortized cost basis of the securities and was required to be recognized in net income (amounts were previously recorded in Other Comprehensive Income as an unrealized loss) due to our intent to sell these securities to repay our \$150 million convertible note due August 1, 2018. This non-cash charge is not related to or indicative of our ongoing core operating performance.



# Footnotes (cont.)

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- (F) **Amortization of contract acquisition costs - ASC 606 initial adoption.** Upon adoption of Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606) (“ASU 606”) using the modified retrospective approach, we capitalized approximately \$3.3 million of previously expensed sales commissions from 2015, 2016 and 2017. Amortization of these amounts is included in our GAAP presentation as sales and marketing expense. We believe this non-cash amortization expense is not related to or indicative of our current or future operating performance.
- (G) **Non-cash interest expense.** Under GAAP, we are required to separately account for liability (debt) and equity (conversion option) components of the \$150 million convertible senior notes that were issued in August 2013. Accordingly, for GAAP purposes we are required to recognize effective interest expense on our convertible senior notes which includes interest cost related to the amortization of debt issuance costs and the contractual 1.5% interest rate of the note. The difference between the effective interest expense and the contractual interest expense is excluded from our assessment of our operating performance because we believe that this non-cash expense is not indicative of ongoing operating performance. We believe that the exclusion of the non-cash interest expense provides investors a view of our core operating performance.
- (H) **Income tax effect on non-GAAP adjustments as well as the impact of normalizing the effective income tax rate.** This adjusts (i) the provision for income taxes to reflect the effect of the non-GAAP items A, B, C, D, F, H and I on our non-GAAP net loss; (ii) the income tax rate to a normalized effective tax rate of 26.5% for three and six months ended June 30, 2018 and 40% for three and six months ended June 30, 2017; and (iii) non-GAAP earnings per share based on a fully-diluted share count.
- (I) **Non-GAAP basic net income per share.** For this per share reconciliation, basic share count was used.