Q3 2014 Earnings Call

October 30th 2014

Important Information

- This presentation contains forward-looking statements within the meaning of the U.S. federal securities laws that involve risks, uncertainties and assumptions. If the risks or uncertainties ever materialize or the assumptions prove incorrect, our results may differ materially from those expressed or implied by such forward-looking statements. All statements other than statements of historical fact could be deemed forward-looking, including, without limitation, statements regarding: predictions for future growth, our possible or assumed future results of operations; estimates of service revenue opportunity under management and annual contract value; our ability to improve our customers' renewal rates, margins and profitability; our ability to increase our revenue and contribution margin over time from new and existing customers; business strategies; technology and product development; competitive position; the effects of competition; third party and company estimates of market sizes; our long term business model; economic, industry and market trends; potential growth vectors and opportunities; comparative models; and statements about partnerships or acquisitions.
- Typically, these statements contain words such as "if," "believe," "may," "will," "estimate," "continue," "anticipate," "intend," "expect," "opportunity" and similar expressions.
- You are cautioned that 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. We undertake no obligation, and do not currently intend 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 periodic reports and registration statements 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 herein and our earnings 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.

Q3 Non-GAAP Operating Expenses*

In $ millions except e.p.s.	Q3 2014	Q3 2013
Cost of Revenue	$ 47.3	$ 38.1
% of revenue	*73%*	*57%*
Sales & Marketing	12.6	11.2
% of revenue	*19%*	*17%*
Research & Development	5.7	4.6
% of revenue	*9%*	*7%*
General & Administration	9.0	9.0
% of revenue	*14%*	*14%*
Total Operating Expenses	74.6	62.9
% of revenue	*115%*	*95%*
Adjusted EBITDA	(7.4)	5.3
% of revenue	*-11%*	*8%*
Non-GAAP Net Loss	$ (6.3)	$ 2.0
Non-GAAP EPS	$ (0.08)	$ 0.02
Shares used in calulating basic net loss	83.1	84.2

*** All metrics are Non-GAAP and exclude, where appropriate, stock-based compensation expense, acquisition related costs, amortization of internally developed software and purchased intangibles and non cash interest expense. Revenues do not reflect the adjustment relating to the write-down of acquired deferred revenue.**

Q4 Guidance – Key Metrics*

CONSOLIDATED

In $ millions except e.p.s.	Q4 Low	Q4 High
Revenue Range	$ 65.0	$ 70.0
y/y growth	*-16%*	*-9%*
Gross Margin	27%	30%
Operating Expense (% of revenue)		
Sales & Marketing	20%	19%
Research & Development	8%	8%
General & Administrative	15%	14%
Adjusted EBITDA	(8.0)	(5.0)
Non-GAAP Net Income	(6.5)	(5.0)
Non-GAAP E.P.S.	(0.08)	(0.06)
Free Cash Flow	$(15.0)	$(11.0)

SEGMENTS

In $ millions	Q4 Low	Q4 High
Managed Services		
Revenue Range	$ 58.0	$ 62.0
y/y growth	*-20%*	*-14%*
Estimated Gross Margin	27%	29%
Subscriptions		
Revenue Range	$ 7.0	$ 8.0
y/y growth	*58%*	*80%*
Estimated Gross Margin	78%	80%
Professional Services		
Revenue Range	$ 0.0	$ 0.1
y/y growth	*nm*	*-81%*
Estimated COGS	$ 3.3	$ 3.3

*** All metrics are Non-GAAP and exclude, where appropriate, stock-based compensation expense, acquisition related costs and amortization of internally developed software and purchased intangibles. Revenues do not reflect the adjustment relating to the write-down of acquired deferred revenue.**

Q4 GAAP to non-GAAP Reconciliation Tables

GAAP to Non GAAP – Gross Margin

(In thousands) (Unaudited)		Three Months Ended December 31, 2014
GAAP Gross Profit		$15,200 - $18,600
Non-GAAP adjustments:		
Adjustments to revenues	(A)	300
Stock-based compensation	(B)	1,200
Amortization of internally-developed softw	(C)	500
Amortization of purchased intangible asset	(D)	400
Non-GAAP Gross Profit		$17,600 - $21,000

GAAP Gross Margin		23% - 27%
Non-GAAP adjustments:		
Adjustments to revenues	(A)	0%
Stock-based compensation	(B)	2%
Amortization of internally-developed softw	(C)	1%
Amortization of purchased intangible asset	(D)	1%
Non-GAAP Gross Margin		27% - 30%

Certain totals may not add due to rounding

Service Source

GAAP to Non GAAP – Net Loss & eps

(In thousands) (Unaudited)		Three Months Ended December 31, 2014
GAAP net loss		$(21,000) - $(18,000)
Non-GAAP adjustments:		
Adjustments to revenues	(A)	300
Stock-based compensation	(B)	5,500
Amortization of internally-developed softw	(C)	600
Amortization of purchased intangible asset	(D)	600
Non-cash interest expense	(E)	2,000
Restructuring Expense	(F)	1,000
Income tax effect on non-GAAP adjustments and impact of normalizing the effective income tax rate	(G)	$3,000 - $4,500
Non-GAAP net loss		$(6,500) - $(5,000)

(Unaudited)		Three Months Ended December 31, 2014
GAAP basic net loss per share		$(0.25) - $(0.21)
Non-GAAP adjustments:		
Adjustments to revenues	(A)	0.00
Stock-based compensation	(B)	0.07
Amortization of internally-developed softw	(C)	0.01
Amortization of purchased intangible asset	(D)	0.01
Non-cash interest expense	(E)	0.02
Restructuring Expense	(F)	0.01
Income tax effect on non-GAAP adjustments and impact of normalizing the effective income tax rate	(G)	0.05 - 0.04
Non-GAAP basic net income per share	(H)	$(0.08) - $(0.06)

Certain totals may not add due to rounding

Shares used in calculating basic net loss per share on a non-GAAP basis	84,000

Service Source

Net Loss to EBITDA

(In thousands) (Unaudited)	Three Months Ended December 31, 2014
Net loss range	$(21,000) - $(18,000)
Income tax (benefit) provision	-
Interest & other expense, net	2,500
Restructuring and Other	1,000
Depreciation & Amortization	3,700
EBITDA range	$(13,800) - $(10,800)
Stock-based compensation	5,500
Adjustments to revenues	300
Acquisition related costs	-
Adjusted EBITDA range	$(8,000) - $(5,000)

Cash Flow from Operations to Free Cash Flow

(In thousands) (Unaudited)	Three Months Ended December 31, 2014
GAAP net cash provided by operating	$(13,000) - $(9,000)
Less:	
Capital expenditures	$ 2,000
FX adjustment	-
Free cash flow	$(15,000) - $(11,000)

Footnotes

(A) Adjustments to revenue - Due to purchase accounting rules, upon acquisition, we recorded an adjustment of $1.7 million to reduce the balance of deferred revenue related to the assumed client contracts acquired from Scout Analytics. As a result of this adjustment, $0.3 million of revenue was not recognized for the three months ended September 30, 2014 and $1.1 million for the nine months ended September 30, 2014. Therefore, revenue is adjusted by an increase of $0.3 million to arrive at non-GAAP revenue for the three months ended September 30, 2014 and $1.1 million to arrive at non-GAAP revenue for the nine months ended September 30, 2014.

(B) 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.

(C) 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.

Footnotes (cont.)

(D) 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, as items arising from pre-acquisition activities determined at the time of an acquisition. While 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.

(E) 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

(F) Restructuring and other expense. Included in our GAAP presentation, we will incur expenses with our announced restructuring effort to reduce expenses to better match revenues. We expect this restructuring effort to occur over the next several quarters. These costs would incur employee severance costs and also costs related to cancellation of contracts or loss of future benefit. These are one-time in nature costs that are not indicative of our core operating performance.

(G) 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, E ,F, G and H noted above on our non-GAAP net loss; (ii) the income tax rate to a normalized effective tax rate of 40%; and (iii) non-GAAP

(H) For this per share reconciliation, basic share count was used