SERVICESOURCE®

The Customer Journey Experience Company

Q4/FY 2020 Earnings Conference Call: February 25, 2021

Prepared Remarks

Elise Brassell, Head of Corporate Communications

Thank you, Operator. We appreciate everyone joining us today and welcome to ServiceSource's earnings call to discuss our results for the fourth quarter and full-year ended December 31st, 2020. On the call today are Gary Moore, ServiceSource's Chairman and CEO, and Chad Lyne, our CFO.

As a reminder, our SEC filings and the earnings release we issued yesterday after market close are available on our website at www.ir.servicesource.com. In addition, we have posted earnings slides to accompany our comments today. Shortly after this call, we will post an audio replay and a copy of our prepared remarks to our website.

Before we begin, I would like to remind you that during the call we will make projections or forward-looking statements that involve risks related to future events. All statements made during the call reflect our views as of today, February 25th, 2021, and are based upon the information currently available to us. All projections and forward-looking statements should be considered in conjunction with the cautionary statements in the earnings press release and the risk factors included in our SEC filings, including our report on Form 10-K. These documents contain and identify important factors that could cause actual events and results to materially differ from those contained in our projections and forward-looking statements, and we disclaim any duty to revise or update any forward-looking statements.

In addition, during the call we will also be discussing certain non-GAAP financial measures, which we believe provide additional information to enhance the understanding of how management assesses the operating performance of the business. The reconciliation of the GAAP and non-GAAP measures can be found in the earnings release that accompany this call.

And with that, I will turn the call over to Gary.

Gary B. Moore – Chairman and Chief Executive Officer

Thanks so much, Elise, and welcome everyone to our earnings conference call for the fourth quarter and full-year 2020.

As we reflect on the accomplishments of 2020, it's important to first appreciate and acknowledge the global ServiceSource team. Your perseverance, drive to perform for the brands we serve, and determination in the face of significant disruption caused by COVID-19, allowed us to deliver for our clients and meet our commitments. I have led companies through many economic cycles and external shocks, yet this has been a year like none of us have ever seen. And while our teams have not been physically together for most of the year, our company continues to demonstrate our values of Dedication, Collaboration, Trust and Caring. As a team we enter 2021 stronger and better positioned to fulfill our Vision of transforming the B2B customer journey experience.

In the fourth quarter and over the course of 2020, our teams delivered for our clients during a time of wide-ranging disruption. Through this period, we grew closer to the world-class brands we serve and improved the health of our partnerships. We fully committed to a virtual first operating model that will define how and where we deliver our solutions going forward. And importantly, we demonstrated the strength and resilience of our people and our business with solid operating and financial performance.

Throughout the uncertainty of last year, market-leading technology companies relied on ServiceSource to preserve the value of their existing customer relationships and enhance the return on their go-to-market investments. Literally overnight, the customer journey experience for B2B buyers and sellers went remote and digital. As marketing events were cancelled and sales pipelines dried up, we saw customer success and renewals become board-level priorities. Customer retention quickly became the de facto growth engine for many technology companies. At the same time, with corporate travel paused and field sales teams grounded, digitally-enabled virtual selling became the dominant form of B2B customer acquisition and engagement. These shifts have been underway and talked about for some time, but the rapid disruption caused by COVID-19 accelerated several years' worth of digital transformation into a couple quarter span for many companies. Longer-term, we believe these dynamics will play to our favor and we are well-positioned to capture a large and growing market opportunity.

Two years ago on my first call with the investment community as ServiceSource's CEO, I laid out my vision and strategy to reposition the Company on a path to growth and improved profitability that would drive long-term value for our stockholders. I was also transparent and offered a candid assessment that the journey would possibly be measured in years – not quarters – and that the trajectory would likely have some ups and downs – and not be linear. Since then, and despite the macro headwinds encountered last year, we have continued to make disciplined progress across the business. You can see this in our performance in the fourth quarter and for the full-year 2020.

On the financial front, the operating environment adversely impacted many of our clients, and ultimately the revenue we realize from the outcomes we generate on their behalf. In the face of this topline pressure, we took swift and decisive action to enhance productivity, rationalize certain programs and engagements, improve spans of control, and simplify our cost structure. The results of these actions are clear, with meaningful year-over-year expansion of non-GAAP Gross Profit margin in both Q4 and the full-year, and Adjusted EBITDA that also exceeded prior year results.

Although the year unfolded much differently than we had assumed coming into it, our commitment to our longer-term playbook did not change. Our vision and values brought clarity of purpose for all of our employees. And our strategic pillars of Inspire Success, Impact Scale, Ignite Sales, and Innovate Solutions kept us aligned as a team on the metrics and priorities that mattered most.

We all had to find new ways of working, interacting, and engaging in 2020. I am really proud of how our Sourcers around the globe leaned-in to this new world of work. As I have shared with you in the past, my leadership team and I have been very focused on the culture of the company, ensuring that we offer a rewarding and fulfilling employee experience to a diverse and inclusive workforce. The outcomes we are seeing here continue to be encouraging. Our employee net promoter score improved more than 12 points in our latest global survey, with our people indicating they feel more motivated, appreciated, and cared for. This positive tone carried over to our employee retention rate, where we had a more than 20 percentage point year-over-year improvement, reaching the highest level we have seen in more than six years.

Importantly, our clients benefitted by having this more tenured, experienced, and motivated team on the frontlines engaging daily with their prospects, customers, and end-users. For the vast majority of our clients, the pandemic has had a more pronounced impact on their mid-market and SMB customer base. IT budgets were frozen or cut back, multi-year maintenance contracts were reduced in scope or duration, purchase cycles were elongated, and companies pushed for more aggressive price concessions and discounting from our clients. Our representatives and managers did an amazing job of handling these tough conversations on behalf of our clients, helping to preserve the value of their customer base and mitigate the risk to their revenue as much as possible. While a bit hard to measure, I firmly believe our flexibility and responsiveness to best support our clients through these times has generated a great deal of goodwill.

In my conversations with our executive sponsors, they increasingly see us as a strategic partner and enabler. They may initially work with us based on our customer journey experience domain expertise, global scale, multilingual coverage, and two decades of process excellence. But what our clients truly value are the market and customer insights, industry best practices, and tactical recommendations we uniquely provide, which enable them to accelerate their own go-to-market strategies and digital transformations.

Bringing this value to the forefront – for both existing clients and new prospects – is helping to bring better results and greater velocity to our land-and-expand efforts. After a disappointing first quarter of 2020, our new bookings from Q2 through Q4 increased more than 25% compared to the same period in 2019, while the fourth quarter alone was our best Q4 since 2017.

We were thrilled to onboard two new logo clients in the fourth quarter. The first was a digital operations management platform provider and a high growth market leader. We are now live with a proactive customer success and renewals management program that is designed to help this client drive higher ARR retention rates and minimize churn. The second win was with Nextiva, a Unified Communications as a Service company that is growing more than 30% annually. We have now launched a customer acquisition and conversion program that will allow this client to improve their pipeline coverage and enhance the ROI on their marketing spend.

In total, we had six new logo wins in 2020, double the number we achieved in 2019. We anticipate continuing to build on this momentum, particularly in the cloud and software vertical where we see greater growth opportunity and where our value proposition is resonating very well.

On the expansion front, we were awarded new business from seven of our current top ten clients during the year, demonstrating the value of the investments we have made in our global account management and outside sales teams. And finally on the renewals front, we renewed or extended approximately 81% of the annual contract value that came up for renewal during the year. In aggregate, while our full-year bookings and churn results were not at the levels we planned for, we feel we executed well against the macro backdrop and did not lose business due to performance or things more closely within our control.

As I wrap-up here, it's worth revisiting what we spoke about with you last quarter. We shared how COVID-19 had time-shifted out by several quarters our expectation to return to growth. With another quarter behind us, we are encouraged by signs of market optimism and improving forecasts for global technology spend. However, we still see difficult operating environments within many of our clients' businesses. We expect these dynamics will continue to impact the books of business and customer opportunity sets that we manage on our clients' behalf. While this will create some pressure on our financial results over the next couple quarters, we anticipate that we will see improvement in the back half of this year, putting us in position for a return to growth. Notwithstanding these factors – which we believe are market-specific and shorter-term in nature – we continue to have high confidence that we have the right strategy, team, priorities, and focus to build a growing, profitable, and more valuable enterprise. We have made – and will continue to make – substantive changes in the business to continue to improve our execution and accelerate our path forward. We are proud of how we closed 2020 on a positive note in many areas, and we look forward to these areas of progress showing up in our results as we get further into 2021.

With that, let's turn to Chad to cover the financials…

Chad Lyne – Chief Financial Officer

Thank you, Gary, and good day to everyone.

It's a pleasure to join you today and I look forward to sharing more detail on our fourth quarter and full-year 2020 financial results. I will also spend a few minutes providing some context for how we are approaching 2021 as we position our company to address the opportunities and challenges that Gary shared.

On balance, we executed well in 2020 and finished on a strong note, with clear indicators of progress across the business despite a challenging external operating environment. Our disciplined execution and expense rigor drove sequential and year-over-year improvements at many levels of our P&L. Our focus on our people, culture, and organizational structure contributed to meaningful gains in our productivity and unit economic metrics. And our Clients For Life operating philosophy and market-facing investments resulted in higher satisfaction, new business wins, and revenue growth at many of our largest and longest-tenured clients.

We also pivoted and moved quickly to course-correct any areas that were not in-line with our internal targets. Gary touched on our bookings and churn results not meeting our full-year expectations given the impact of COVID-19 on our clients and prospects. That said, we also saw opportunities to upskill our talent, improve our execution, enhance our solutions, and refine our pricing to better compete and win in the market. We are encouraged by the early results and look forward to ongoing progress here.

Now, let me now walk you through our Q4 and full-year 2020 results.

Turning first to Q4 --- We generated Revenue of $51.1 million, down $3.8 million, or 6.9%, year-over-year. We benefitted from some strong sequential and seasonal growth at several of our larger clients. Customers who had been on the sidelines and delayed purchase or renewal decisions over the course of 2020 finally came to the table and transacted at year-end. This uplift on some of our pay-for-performance engagements helped to offset more than $5 million of year-over-year contraction tied to churned or proactively rationalized accounts.

Our fourth quarter non-GAAP Cost of Revenue was $32.0 million, favorably down $4.2 million, or 11.6%, year-over-year. Average headcount in the quarter was down more than 13% year-over-year, contributing to a more than 7% increase in our revenue-per-employee metric. Fourth quarter non-GAAP Gross Profit was $19.1 million, or a margin of 37.3% of Revenue. This was up approximately 400 thousand dollars or 330 basis points year-over-year and marks our highest quarterly non-GAAP Gross Profit margin since Q4 of 2017.

Fourth quarter non-GAAP Operating Expenses of $15.7 million were favorably down $1.9 million, or 10.8%, year-over-year, as we made further progress to align the cost structure to our current scale while continuing to invest in our focus areas.

At the bottom line, Adjusted EBITDA in the fourth quarter was $4.8 million, or 9.5% of Revenue. We are very proud of how the team executed in Q4 to drive this result, with an improvement of $2.1 million and approximately 450 basis points compared to the fourth quarter of 2019.

Shifting to our full-year 2020 results --- Revenue of $194.6 million was down $21.5 million, or 10.0%, year-over-year. More than half of this was from the large client we have discussed with you in prior calls, as they shifted priorities and reduced their investment with us over the course of the year in response to changes in their business. Approximately $5 million was due to a former client, which you will recall we spoke about in the past when we made the decision to proactively exit this sub-optimal program in late 2019 to focus on higher margin work that better aligned with our strategy. Beyond these two callouts, the remainder was due to other churn and contraction from 2019 and 2020 that was higher than the revenue recognized from new business wins and expansions.

Despite the impacts of the pandemic on our clients, we demonstrated growth across our largest relationships. As Gary mentioned, we sold new business to seven of our current top 10 clients, and in total we had net bookings in excess of any lost business across these top 10 clients. In terms of Revenue, when you normalize for the large client I discussed a minute ago that is still within our top 10 cohort, the other nine clients in aggregate grew Revenue more than 5% year-over-year.

Moving to the rest of the P&L --- we addressed the year-over-year Revenue headwind aggressively and proactively, reducing our non-GAAP Cost of Revenue by $17.3 million, or 11.7% year-over-year. Non-GAAP Gross Profit of $63.4 million was down $4.2 million year-over-year. Non-GAAP Gross Profit margin was 32.6%, up 130 basis points year-over-year.

Full-year non-GAAP Operating Expenses were $65.3 million, or 33.6% of Revenue. Enabled by the acceleration of our virtual first operating model, we took deliberate and strategic actions to drive greater efficiency and lower our expense base by $5.7 million year-over-year.

Our focus on improved operational execution, higher productivity, and expense discipline at all levels contributed to full-year 2020 Adjusted EBITDA of $4.3 million, or 2.2% of Revenue, up approximately $100K and 30 basis points from the prior year despite the lower topline profile.

Turning to the balance sheet and cash flow highlights --- we maintained a solid cash and liquidity profile while continuing to invest in areas that we believe will further differentiate our capabilities, accelerate growth, enable automation, and unlock future saving opportunities.

DSOs were 69 days, up one day year-over-year and up three days sequentially from Q3. Cash Flow from Operations for the full-year 2020 was positive approximately $400 thousand, down $12.0 million year-over-year due to the impact of working capital and a lower Revenue base. CAPEX – inclusive of capitalized internally developed software – was $7.9 million in 2020 and down $2.3 million year-over-year, and this includes a large-scale global refresh of our endpoint devices to enable our secure, virtual first operating model. Free Cash Flow was negative $7.5 million in 2020, compared to positive $2.3 million in 2019.

We ended the year with $36.3 million of cash, cash equivalents, and restricted cash, inclusive of $15 million outstanding on our revolving line of credit. Total available liquidity as of December 31st, 2020, was $45.2 million.

With 2020 results behind us, I want to now spend a few minutes providing additional context to the macro outlook that Gary discussed in his remarks. We anticipate the first half of the year will have more pronounced challenges from a year-over-year comparison standpoint, with a return to growth in the back half of the year. There are two key factors at play here. First, is the normal seasonality that you see in our business given the size and timing of end-customer contracts that we support for our clients. This typically causes first-half revenue from our installed base to come in 8-12% lower than second-half revenue from the prior year. The second factor relates to COVID-19's impact on the opportunity we have under management, and how that book of business converts into client bookings, which drives our revenue. Across many of our clients, the mid-market and SMB customer tiers we manage are showing some signs of improvement, but generally continue to be under pressure. We do believe this segment-specific pressure will begin to abate later this year as the economic recovery takes hold and buyer confidence and IT budgets return in these tiers. In the meantime, we remain focused on mitigating the impact of these factors through improved performance and other operational levers within our control.

Taking a step back and looking at the market more broadly, we are encouraged by the anticipated growth in the various forecasts we track. Worldwide GDP is expected to rebound strongly, particularly in the second half of the year. Global IT spend, as measured by market research firm Gartner, is forecast to track in-line with the broader economy, bouncing back from 3.2% contraction in 2020 to 6.2% growth in 2021. Peeling back to the areas within IT that we more directly address, including software and hardware maintenance, license, and subscription revenue, market research firm IDC forecasts these sectors will grow 2.2% this year with acceleration to 9.1% growth by 2024. These outlooks provide structural tailwinds to our business and underpin our conviction that we are positioned in an attractive market with long-run growth upside. And we believe we are bringing the right focus and actions to execute against this opportunity in a way that will allow us to build a business that delivers on our growth, profitability, and value creation priorities.

With that, I will hand the call back over to Gary for any closing comments.

Gary B. Moore – Chairman and Chief Executive Officer

Thank you, Chad. I began this call by thanking our employees for how their perseverance, drive, and performance allowed us to deliver on our brand promise and commitments to our clients. I am incredibly proud of how this team showed up every day to generate the results we just shared. I also want to extend my appreciation to our client partners, who placed their trust in us to help ensure their businesses came through this period stronger and better positioned for the future. And finally, thank you to our stockholders who share our conviction for the future and our ambition for what we are building towards.

With that Operator, please open the call for questions.