SERVICESOURCE®

The Customer Journey Experience Company

Q3 2020 Earnings Conference Call: October 29, 2020

Prepared Remarks

Chad Lyne, EVP – Strategy, Corporate Development & IRO

Thank you, Operator. We appreciate everyone joining us today and welcome to ServiceSource's third quarter earnings call to discuss our results for the quarter ended September 30th, 2020. On the call today are Gary Moore, ServiceSource's Chairman and CEO, and Rich Walker, 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 of this call 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, October 29th, 2020, 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-Q. 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.

<u>Gary B. Moore – Chairman and Chief Executive Officer</u>

Thank you, Chad, and welcome everyone to our earnings conference call for the third quarter of 2020. We demonstrated operational resilience and financial discipline in the midst of a challenging and dynamic macro environment in the quarter. Although the headline Revenue numbers reflect a tough year-over-year comparable, I am encouraged by the progress we continue to make throughout the organization. We won new business on both the new logo and installed base client front, are doing a better job executing on our brand promise, and are moving forward well with our Virtual First Operating Model. We improved profitability sequentially from Q2, generated Free Cash Flow of $3.4 million, deleveraged the balance sheet further, and accreted Net Cash in the quarter. Looking forward, I have conviction that we are aligned to an attractive long-term market opportunity, with multiple avenues for us to accelerate our strategy, enhance our growth and profitability metrics, and transform our valuation profile.

We recently hosted a virtual executive roundtable with more than a dozen executives from market-leading technology companies – including a mix of current clients and those with whom we are working to partner. The discussion with these leaders was representative of what we have been seeing and hearing in the market more generally. Regardless of whether a company is selling hardware or software, delivering on-premise or through the cloud, or monetizing through licenses or subscription and consumption-based billing – the challenges and opportunities are the same. Go-to-market transformation and customer-centric initiatives are at the top of the C-suite agenda.

The unifying priority for these companies and their leaders is a focus on delivering a better experience throughout the pre- and post-sale customer journey. They need sales representatives that are technically savvy and digitally enabled. They need customer success managers that are product experts and outcome oriented. They need renewals representatives that are consultative and growth focused. And underpinning all of these roles, they need data, processes, analytics, and insights that make every single interaction with their customers more efficient and effective. Commentary from experts at leading strategy and consulting firms validate these needs:

- In a recent article from Bain & Company, the headline was "In Enterprise Software, Renewals and Retention Have Never Been More Important."
- And in an October McKinsey & Company thought leadership piece on COVID-19's impact to B2B sales organizations, they identify that more than three-quarters of B2B buyers and sellers now prefer remote human interactions, and digitally-enabled sales have now become the next normal.

These things are at the core of what we do at ServiceSource every day, and we are the market leader in terms of our scale and global presence, our solution scope and capabilities, and our client results and impact.

Allow me to share some recent examples of where our strategic differentiation has resulted in success in the market.

In the third quarter, we secured our fourth new client logo win of the year to support a leading provider of software and related services for the $94 billion health and fitness industry. Operating in a competitive environment and facing market disruption caused by COVID-19, the company saw an opportunity to accelerate their go-to-market activities by leveraging ServiceSource's demand generation and conversion capabilities. In a testament to our Virtual First Operating Model and our focus on moving with greater speed and agility, we were able to go from contract signing to being live in production with a remotely hired and trained team within 30 days. We are thrilled to welcome another new client to our software and SaaS vertical and look forward to supporting their ambitious growth objectives.

In another third quarter success, we were very pleased to extend and expand our multi-year partnership with Qlik, a provider of an end-to-end, real-time data integration and analytics cloud platform. Since 2016, we have played an integral role in supporting Qlik's customer growth and retention initiatives. We have managed a holistic global program across a variety of customer success motions to allow Qlik to achieve a more predictable and on-time renewal rate. In addition, our partnership has driven continuous innovation, promoting deeper customer insights and higher end-user satisfaction. It is this consistent performance, co-innovation mindset, and strong partnership alignment that allowed us to renew our agreement with Qlik for another three-year term. We are thankful for their ongoing partnership and are excited to continue to deliver results that will accelerate their strong momentum.

The last success story I am going to share is evidence of our land-and-expand strategy and our ability to grow with our installed base of clients. In this case, we already managed and influenced approximately $1.5 billion of annual revenue for one of our clients through a large-scale global renewals management program. This cloud and software company has experienced strong organic growth rates, and they have further complemented their growth with strategic acquisitions. Given our multi-year relationship and consistently strong performance in their core business, this client turned to us to launch a new program for one of their recent acquisitions, a cybersecurity company growing in excess of 30% annually. We designed and implemented a solution and launched a remote team of professionals that went live within weeks across North America, Europe, and Asia. Our client can now focus their internal resources on larger enterprise deals knowing that they have a trusted partner in ServiceSource to enhance the renewal rate and lifetime value of the acquired company's small- and mid-sized customers.

These wins and expansions highlight how we are well-positioned to address a variety of client business challenges.

Looking forward, we can't speculate on how the pandemic will play out or exactly when the economy will return to a more normalized environment. However, success stories like the ones I shared and viewpoints from third-party experts underpin our conviction that our strategy, solutions, and capabilities are strongly aligned to current and emerging market opportunities.

Before I turn the call over to Rich to cover our financial results, I want to personally convey my heartfelt thanks and appreciation to him for a job well-done. As we announced yesterday afternoon, Rich has decided to step down as CFO, and as of November 1st will pass the baton to Chad Lyne, who many of you know personally and who is on the call with us today. Two years ago, Rich accepted a request from our Board to fill a vacancy in the CFO seat. Since that time, he has been a trusted business partner and a tremendous asset to the Company. Together with other members of my leadership team, we moved some heavy rocks and strengthened the business and made important strides on our long-term transformation. Rich – it's been a great pleasure having you at my side for these two years and I am thrilled that you will continue to be involved as a Board member.

With that, let's turn to the financials…

Richard Walker – Chief Financial Officer

Thank you for the kind words, Gary, and good day to everyone.

Before I jump into the financials, let me just share some thoughts on the transition to Chad. Although I will be leaving my day-to-day role with ServiceSource, my conviction in the Company's strategy and my commitment to its success have never been stronger. As I began contemplating possible changes that would allow me to spend more time with my wife and pursue some other areas of interest, I took great comfort knowing that we already had a robust Board-reviewed succession plan in place. Chad brings more than two decades of broad-based finance experience and more than four years as an executive leader at ServiceSource – including the last two where I have had the pleasure of working closely with him on many key initiatives. I have no doubt that Chad is the right person to now take the reins and I am delighted that our world-class finance and accounting organization will be led by someone with his character and expertise.

As Gary covered in his opening remarks, we saw ongoing progress financially and operationally in the third quarter. Like other companies in the technology industry, our expectations entering the year have been time-shifted out by several quarters due to COVID-19's global impact. And although the markets and clients we serve are not out-of-the-woods yet in terms of the challenges posed by the pandemic, on balance we do see more encouraging signs compared to when we last spoke with you on our second quarter call.

Turning to our topline results --- In the third quarter, we generated Revenue of $45.8 million, down $7.6 million, or 14.2%, year-over-year. More than 70% of this year-over-year contraction is tied to churned or proactively rationalized accounts. As we continue to roll this Revenue off, the overhang will persist for a while until we lap the tougher compare.

Looking at our largest clients over a multi-quarter horizon, we had Revenue growth with four of our top ten logos on a trailing twelve-month basis. We continued to face pressure from a large client we mentioned on our August call who is adapting to some market challenges that cause it to weigh on our overall results. Excluding their impact, we had trailing twelve-month Revenue growth of nearly 5% across the other nine largest clients. And on the retention front, year-to-date through Q3 we renewed or extended approximately 87% of the contract value that was up for renewal.

Shifting to Cost of Revenue and Gross Profit --- Our non-GAAP Cost of Revenue was $31.7 million, favorably down $5 million, or 13.6%, year-over-year. We prudently managed our capacity in-line with our Revenue trends while ensuring we continued to invest in client growth areas and new logo ramps.

Average headcount in the quarter was down more than 15% year-over-year and our revenue per employee metric was up modestly. Non-GAAP Gross Profit margins of 30.8% of Revenue were down approximately 50 basis points year-over-year, but were up approximately 60 basis points sequentially compared to Q2 despite a lower Revenue base.

Continuing to walk down the P&L --- Non-GAAP Operating Expenses of $15.8 million were favorably down $1.5 million, or 8.6%, year-over-year. We continued to reduce or reallocate spend from lower-return areas to allow us to focus our investments on areas of opportunity that align to our strategic priorities and long-term growth objectives.

At the bottom line, Adjusted EBITDA was negative two-hundred thousand dollars, down approximately $1.3 million year-over-year, but slightly improved sequentially from our Q2 results.

Turning to the balance sheet and cash flow highlights --- we had very strong execution in the quarter and bolstered an already solid balance sheet. DSOs came in at a record low of 66 days, a reduction of eight days year-over-year and down an even more impressive ten days sequentially from Q2.

Cash Flow from Operations in Q3 was positive $5.9 million, up markedly from five-hundred thousand dollars in the same period last year. Combined with a six-hundred thousand dollar year-over-year reduction in CAPEX – inclusive of capitalized internally developed software – we generated *positive* Free Cash Flow of $3.4 million in Q3, compared to *negative* Free Cash Flow of $2.6 million in the year-ago period.

With our improvements in Free Cash Flow, we took the opportunity to reduce the amount outstanding on our revolving line of credit by $5 million. With $15 million outstanding on the line and a cash balance – including cash equivalents and restricted cash – of $41.5 million, we ended Q3 with a Net Cash position of $26.5 million, an increase of $3.3 million from Q2.

Before I hand the call back to Gary, I would just like to share my appreciation to all of the employees at ServiceSource that I have had the pleasure of working with for the past two years. It has been an incredibly rewarding and meaningful period in my career. Although a lot has been accomplished, I look forward to the progress that will be made in the quarters and years to come. And with this being my last call, I would be remiss to not thank the stockholders on the phone with us who have supported our ongoing transformation journey. Gary – back over to you.

Gary B. Moore – Chairman and Chief Executive Officer

Thank you for that, Rich. In summary, we continue to perform and execute well amidst what remains a challenging macroeconomic environment. We are making important strides to strengthen our financial profile while also investing wisely for the future. We are winning in the market with new clients while also delivering compelling value and securing expansions with many of our existing clients. And we are committed to making near-term progress throughout the business while keeping a sharp focus on our longer-term opportunity and objectives.

With that Operator, please open the call for questions.