SERVICESOURCE®

The Customer Journey Experience Company

Q3 2021 Earnings Conference Call: November 2, 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 third quarter ended September 30th, 2021. 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 today 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, November 2nd, 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-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.

Gary B. Moore – Chairman and Chief Executive Officer

Thank you, Elise. And thank you everyone for joining us for our earnings conference call for the third quarter of 2021.

As we announced in the earnings release this afternoon, we had a strong third quarter on multiple fronts. When we spoke with you in February to provide context on our 2021 outlook, we had committed to returning the business to year-over-year revenue growth in the second half. I am very pleased to share that we delivered on that commitment and realized a revenue inflection in Q3 with more than 6% year-over-year growth. We also saw notable gains on profitability year-over-year, including a nearly 200 basis point increase in non-GAAP gross profit margins and a more than $2 million positive swing in Adjusted EBITDA.

I am encouraged by our performance in Q3 and the validation it provides of our ongoing commitment to client success and our focus on operational excellence. Our third quarter performance is a direct result of us doing a better job executing with a Clients-For-Life mentality and bringing differentiated solutions to bear for future-focused growth enterprises.

In an increasingly digital era, the need for business model innovation and transformation has never been more pressing for the markets and companies we serve. This has caused technology companies to fundamentally rethink and redesign everything, starting first with their products and pricing models, more recently their services and support, and now increasingly, their go-to-market and customer engagement models.

Now more than ever, customer experience is the key success enabler and the most important competitive differentiator. Companies large and small are recognizing that they need to view their B2B customer relationships on a personal level. Engagement needs to be proactive and continuous, versus reactive and one-off. We have pioneered the best practices behind many of these shifts, and we are uniquely positioned to help companies accelerate through these transitions.

In a world where B2B customers are more informed and empowered than ever before, they are demanding human-centric, digitally-enabled engagement from their technology partners. In a recent global survey, a leading strategy consulting firm found that 92% of B2B buyers prefer virtual sales interactions. We've been a leader in this space for more than 20 years.

Companies are responding to these buyer preferences, both to improve customer satisfaction and loyalty, as well as to enhance coverage and cost effectiveness. More than 80% of business leaders in another survey indicated that newer digitally-powered omnichannel sales models are more effective than legacy in-person and field-based approaches.

Our solutions around virtual inside sales, customer success and renewals, and channel management, are positioned at the forefront of this market shift, and we believe this shift is accelerating. In our own internal research, we have seen twice as many companies reference “customer success” in their annual reports in the past three years. And on earnings calls, we’ve seen a more than 70% increase in the number of companies discussing their focus on the go-to-market motions that ServiceSource provides.

These datapoints underpin our perspective that we are in the early innings of a structural transformation in the technology market. The imperative to win the hearts and minds of customers is causing a fundamental redesign in how companies organize and operate to accelerate customer acquisition, success, and retention.

The shift is across hardware, software, and cloud companies. It’s across sectors, from compute, storage and networking, to collaboration, productivity and security. And it spans categories, from MedTech, to FinTech, to EdTech, and to Industrial IoT.

Companies are adapting and innovating their go-to-market models across these three lenses of people, process, and technology. We have perfected the integration of these three vectors to improve the Customer Journey Experience using the latest in high performance selling techniques and omnichannel engagement. Working with the elite industry leaders that we do, we are continuously learning, improving, and sharing best practices broadly across our client base, uniquely positioning us as a trusted advisor and transformation enablement partner.

For a company like DropBox, a global leader in cloud storage and content collaboration, we emerged as a partner of choice given our robust and flexible offerings and our experience in multiple sales motions. Signed in Q3, we are in the process of ramping globally to help Dropbox fortify their virtual inside sales efforts with innovative customer identification, acquisition, and outreach strategies.

In another example, we’ve been partnered with one of the world’s largest software and cloud companies for nearly 15 years. In the third quarter, we won the opportunity to scale a new global team to support the renewal, upsell, and cross-sell of enterprise service contracts across more than a dozen of this client's subsidiaries and operating units in Europe and North America. We recently completed our first few phases of go-live, and once fully ramped, we expect this expansion to contribute in excess of $5 million of annualized revenue.

In addition, the discipline and rigor that Mike Naughton – our EVP of Global Client Delivery – and his team have built into our Clients-For-Life mentality and Global Operating Model are shaping our client outcomes for the better. One example here comes from our strategy to optimize parts of our portfolio where we saw an opportunity to improve economics and commercial terms. We've had a great partnership and have supported a market leader in the networking space for more than a dozen years. But over time, the profit profile became increasingly dilutive. Our team of nearly 100 professionals around the globe has worked tirelessly to deliver world-class results and exceptional outcomes. These efforts earned us the right in the third quarter to rescope the solution and secure a multi-year contract expansion that will return this book of business to a position of profitable growth.

Earlier this week, we had a quarterly business review with this client, and the feedback from their leadership team was incredible. Allow me to share a bit of the commentary from one of their senior leaders, and I will quote:

> *"Go back and listen to our last two or three earnings calls and listen to [our CEO] describe how impactful the services business has been to [our] overall success…ServiceSource is a part of that success…keep it up."*

Our clients have high expectations for the impact we can deliver, and testimonies like these illustrate the mission-critical nature of what we do for them. Wins, expansions, and client validation like this quote are made possible only by the collective efforts of all of the teams at ServiceSource. So, I would be remiss if I did not take a moment to publicly express my appreciation here in this forum to our people around the world. It's their focus on our clients, their embracing of our core values, and their delivery of our brand promise, that is allowing us to move the business in the right direction.

Touching on a few other operational highlights from the quarter…

On the renewals front, we renewed or extended approximately 94% of the contract value that was up for renewal through the first three quarters of the year. Consistent with last quarter, our focus on closing up-sell and cross-sell expansions along with the renewals resulted in a year-to-date net retention rate above 100%.

Overall, with three quarters behind us, we feel good about the health of our clients and of our relationships with them. Looking forward to Q4 and the full-year, we do believe our retention metrics will trend lower based on notice of a strategic shift at a legacy hardware client, but we feel confident that we should still see year-over-year improvement from last year's retention rate.

Turning to sales, our team brought in the best performance in 10 quarters. On a trailing twelve-month basis through Q3, our bookings were up approximately 22% year-over-year compared to the prior period, thanks to the hard work of Peter Flynn – our head of Sales and Global Account Management – and his team. Including the five-million-dollar expansion I mentioned earlier, we secured new business wins with four of our top ten clients in the quarter.

In early December, I will mark the three-year anniversary of stepping into my role here at ServiceSource. We've made important strides to transform the company. We haven't gotten everything right, and candidly, my initial expectations were that we would be further along on our multi-year journey. That said, I couldn't be more proud of how our collective group of Sourcers has navigated the challenges and opportunities we have faced.

As a team, we've made tough calls that in some instances affected our short-term metrics. But at all times, we've made these decisions with conviction in our longer-term strategy and belief in the impact they would have in allowing us to build a more sustainable and durable business.

To wrap up, our third quarter results demonstrate our improved execution is becoming more evident and tangible. And although we are pleased with our progress year-to-date and our inflection in Q3, we know we still have our work cut out for us on this journey. Looking forward, we will continue to invest in our people and capabilities to ensure we are positioned to capture the market opportunity that we believe is on the cusp of more broad-based adoption and expansion.

With that, I'll hand the call to Chad to cover the financials.

Chad Lyne – Chief Financial Officer

Thank you, Gary. We appreciate everyone taking the time to join us.

We are incredibly proud of the improved execution and enhanced outcomes generated by our teams in the third quarter. We returned to revenue growth consistent with the commitment we made at the beginning of the year. Our topline results in Q3 mark a pronounced inflection, both on a year-over-year basis and when compared to the nearly 7% contraction we had through the first half of 2021. We expanded our non-GAAP Gross Profit margins quarter-over-quarter and year-over-year, realized Adjusted EBITDA margins in the mid-single digit percentages, and generated positive Free Cash Flow.

Our client performance metrics remain near all-time highs, our bookings activity accelerated, and we landed some attractive wins and expansions with high-growth marquee brands. Year-to-date through the third quarter, we have brought onboard three new client relationships, and our marketing and sales team is squarely focused on building, accelerating, and converting pipeline within a market that has more than 700 target companies.

Now, let's turn to our Q3 results.

Revenue of $48.6 million was up $2.8 million, or 6.1% year-over-year. This marks our strongest reported revenue growth since the first quarter of 2014. The year-over-year gains were also fairly diversified and broad-based. All three of our geographic regions returned to growth, including approximately 19% and 13% expansion in APJ and EMEA, respectively. Production uplifts, program ramps, and performance bonuses resulted in growth across eight of our top 10 clients, while our new logo wins from the past two years also drove solid topline contribution.

Our third quarter non-GAAP Cost of Revenue was $32.7 million. Non-GAAP Gross Profit was $15.9 million, or a margin of 32.7% of Revenue, up $1.8 million or nearly 200 basis points year-over-year. On a sequential basis, non-GAAP Gross Profit margins improved about 430 basis points from Q2, as the approximately 150 new hires we made in the second quarter are now further along in ramping to productivity.

Non-GAAP Operating Expenses were $15.1 million in the quarter and represented 31.1% of Revenue, favorably down $0.7 million, or 4.4%, year-over-year.

We continued to see benefit from the actions we took in Q4 of last year to realign areas of spend that were falling short of our return expectations. We also are pleased with the ongoing positive contribution from our virtual-first operating model. Our efforts to rationalize our real estate footprint through a combination of square footage reductions and subleasing activity has allowed us to reduce our quarterly net lease expense by approximately 35% in the past two years, freeing up investment capacity for other more compelling priorities.

At the bottom line, third quarter Adjusted EBITDA was $2.0 million, up $2.2 million year-over-year, and reflected a margin of 4.2% of revenue.

Our balance sheet and liquidity position remained strong. DSOs of 66 days were flat year-over-year and improved one day sequentially from Q2.

Cash flow from operations was $3.9 million. CAPEX – inclusive of capitalized internally developed software – was $0.6 million, resulting in Free Cash Flow of $3.3 million. Year-to-date, we have generated $1.3 million of positive Free Cash Flow, compared with negative $2.3 million in the year-ago period.

We ended the quarter with $32.5 million of cash, cash equivalents, and restricted cash, down from Q2 as we reduced the borrowings on our Revolver. As of quarter-end, we had $10.0 million outstanding and additional availability of $12.2 million on the Revolver, resulting in total available liquidity of $42.4 million.

I realize that with two months left in the year, questions naturally turn to our expectations for Q4 and the full year. We aren't in the position of having enough clarity to offer specific guidance. The pandemic continues to weigh on the global recovery, with the IMF in October lowering its 2021 growth outlook for advanced economies. Many of our clients are still experiencing choppiness in their markets. Typical seasonality patterns have become less predictable, and we've seen more of our clients' forecasts reflecting higher levels of uncertainty due to supply chain constraints, chip shortages, and labor challenges. Although we believe these factors could have some knock-on effect to our business, I will repeat what we have said in the past, that our focus remains on our people, our clients, and the things we can directly control. We feel good about our progress and inflection in Q3, and our teams are heads-down working to close out the year as strongly as possible.

With that, Operator, please open the call for questions, and then we will have Gary come back after any Q&A to close the call.

