

SERVICESOURCE INTERNATIONAL, INC.

Form 10-Q

May 07, 2014

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2014

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-35108

SERVICESOURCE INTERNATIONAL, INC.

(Exact name of registrant as specified in our charter)

Delaware

No. 81-0578975

(State or Other Jurisdiction of

(I.R.S. Employer

Incorporation or Organization)

Identification No.)

634 Second Street

94107

San Francisco, California

(Address of Principal Executive Offices)

(Zip Code)

(415) 901-6030

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Indicate number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date:

Class	Outstanding as of April 30, 2014
Common Stock	83,101,098



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## PART I FINANCIAL INFORMATION

## Item 1. Financial Statements

SERVICESOURCE INTERNATIONAL, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

(Unaudited)

	March 31, 2014	December 31, 2013
Assets		
Current assets:		
Cash and cash equivalents	\$121,943	\$170,132
Short-term investments	124,338	105,001
Accounts receivable, net	64,843	73,113
Deferred income taxes	412	412
Prepaid expenses and other	6,349	6,295
Total current assets	317,885	354,953
Property and equipment, net	27,923	27,998
Deferred income taxes, net of current portion	2,035	2,035
Other assets, net	17,034	8,626
Goodwill	28,987	6,334
Total assets	\$393,864	\$399,946
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$6,648	\$3,610
Accrued taxes	1,136	1,134
Accrued compensation and benefits	18,531	19,610
Deferred revenue	5,682	5,905
Accrued liabilities and other	10,384	9,509
Total current liabilities	42,381	39,768
Convertible notes, net	115,540	113,915
Other long-term liabilities	5,225	5,566
Total liabilities	163,146	159,249
Commitments and contingencies (Note 10)		
Stockholders' equity:		
Common stock; \$0.0001 par value; 1,000,000 shares authorized; 82,643 shares issued and 82,522 shares outstanding as of March 31, 2014; 82,086 shares issued and 81,965 shares outstanding as of December 31, 2013		8
Treasury stock	(441	) (441
Additional paid-in capital	295,112	286,526
Accumulated deficit	(64,990	) (46,250
Accumulated other comprehensive income	1,029	854
Total stockholders' equity	230,718	240,697
Total liabilities and stockholders' equity	\$393,864	\$399,946

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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SERVICESOURCE INTERNATIONAL, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
 (In thousands, except per share amounts)  
 (Unaudited)

	Three Months Ended	
	March 31,	
	2014	2013
Net revenue	\$66,816	\$61,121
Cost of revenue	47,595	38,498
Gross profit	19,221	22,623
Operating expenses:		
Sales and marketing	15,671	14,808
Research and development	6,716	6,248
General and administrative	12,865	11,222
Total operating expenses	35,252	32,278
Loss from operations	(16,031	) (9,655
Other (income) expense:		
Interest expense	2,390	54
Other, net	184	53
Loss before income taxes	(18,605	) (9,762
Income tax provision	135	693
Net loss	\$(18,740	) \$(10,455
Net loss per share, basic and diluted	\$(0.23	) \$(0.14
Weighted average common shares outstanding, basic and diluted	82,077	75,610

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(In thousands)

(Unaudited)

	Three Months Ended	
	March 31,	
	2014	2013
Net loss	\$ (18,740	) \$ (10,455
Other comprehensive income, net of tax:		
Foreign currency translation adjustments	196	65
Unrealized gain (loss) on short-term investments, net of tax	(21	) 31
Other comprehensive income, net of tax	175	96
Total comprehensive loss, net of tax	\$ (18,565	) \$ (10,359

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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SERVICESOURCE INTERNATIONAL, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (In thousands)  
 (Unaudited)

	Three Months Ended	
	March 31,	
	2014	2013
Cash flows from operating activities		
Net loss	\$(18,740	) \$(10,455
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	3,029	3,206
Amortization of debt discount and issuance costs	1,788	12
Accretion of premium on short-term investments and other	(161	) 174
Deferred income taxes	—	461
Stock-based compensation	5,582	5,921
Income tax charge from stock-based compensation	—	181
Changes in operating assets and liabilities, net of impact of acquisition:		
Accounts receivable, net	10,904	5,796
Prepaid expenses and other	412	415
Accounts payable	2,001	2,077
Accrued taxes	(184	) (779
Accrued compensation and benefits	(1,313	) (890
Accrued liabilities and other	(1,305	) (239
Net cash provided by operating activities	2,013	5,880
Cash flows from investing activities		
Acquisition of property and equipment	(1,304	) (1,232
Cash paid for acquisition, net of cash acquired	(32,551	) —
Purchases of short-term investments	(28,357	) (18,034
Sales of short-term investments	8,066	508
Maturities of short-term investments	1,095	500
Net cash used in investing activities	(53,051	) (18,258
Cash flows from financing activities		
Repayment on capital leases obligations	(101	) (80
Proceeds from common stock issuances	2,753	3,741
Income tax charge from stock-based compensation	—	(181
Net cash provided by financing activities	2,652	3,480
Net decrease in cash and cash equivalents	(48,386	) (8,898
Effect of exchange rate changes on cash and cash equivalents	197	277
Cash and cash equivalents at beginning of period	170,132	76,568
Cash and cash equivalents at end of period	\$121,943	\$67,947

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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SERVICESOURCE INTERNATIONAL, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 — Description of Business and Basis of Presentation

ServiceSource International, Inc. (together with its subsidiaries, the “Company”) is a global leader in recurring revenue management, partnering with technology and technology-enabled companies to optimize maintenance, support and subscription revenue streams, while also improving customer relationships and loyalty. The Company delivers these results via cloud-based solutions and dedicated service teams, leveraging benchmarks and best practices derived from its rich database of service and renewal behavior. By integrating software, managed services and data, the Company provides end-to-end management and optimization of the service-contract renewals process, including data management, quoting, selling and recurring revenue business intelligence. The Company receives commissions from its customers based on renewal sales that the Company generates on their behalf under a pay-for-performance model. In addition, the Company also offers a purpose-built Software-As-A-Service (SaaS) application to maximize the renewal of subscriptions, maintenance and support contracts and a SaaS application that enables information services, media publishing, and SaaS companies to understand how customers engage with their online content. The Company’s corporate headquarters are located in San Francisco, California. The Company has offices in Colorado, Tennessee, Washington, United Kingdom, Ireland, Malaysia, Singapore and Japan.

The accompanying unaudited interim condensed consolidated financial statements (“condensed consolidated financial statements”) include the accounts of ServiceSource International Inc. and its subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation.

These condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (“U.S. GAAP” or “GAAP”) for interim financial information, rules and regulations of the Securities and Exchange Commission (“SEC”) for interim financial statements, and accounting policies, consistent in all material respects with those applied in preparing our audited annual consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2013. These condensed consolidated financial statements and accompanying notes should be read in conjunction with our annual consolidated financial statements and the notes thereto for the year ended December 31, 2013, included in our Annual Report on Form 10-K. In the opinion of management, these condensed consolidated financial statements reflect all adjustments, including normal recurring adjustments, management considers necessary for a fair statement of our financial position, operating results, and cash flows for the interim periods presented. The results for the interim periods are not necessarily indicative of results for the entire year.

The December 31, 2013 condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. These unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes for the year ended December 31, 2013 included in the Company’s Annual Report on Form 10-K.

Recent Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board (the “FASB”) issued Accounting Standards Update (“ASU”) No. 2013-2 “Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income.” ASU No. 2013-2 requires an entity to disaggregate the total change of each component of other comprehensive income either on the face of the income statement or as a separate disclosure in the notes. The new guidance became effective for the Company’s interim period ended March 31, 2013. The Company adopted this guidance and the adoption did not have any impact on its financial position, results of operations or cash flows as the amounts reclassified out of accumulated other comprehensive income are not material.

In June 2013, the FASB determined that an unrecognized tax benefit should be presented as a reduction of a deferred tax asset for a net operating loss (“NOL”) carryforward or other tax credit carryforward when settlement in this manner is available under applicable tax law. This guidance is effective for the Company’s interim and annual periods beginning January 1, 2014. The adoption of this guidance did not have a material impact on the Company’s consolidated financial statements.





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## Note 2 — Business Acquisition

On January 22, 2014, the Company acquired Scout Analytics, Inc. (“Scout”), a privately held company. Scout provides cloud-based recurring revenue management solutions that enable information services, media publishing, and SaaS companies to understand how customers engage with their online content.

The acquisition has been accounted for under the acquisition method of accounting in accordance with the FASB's Accounting Standards Codification (“ASC”) Topic 805, Business Combinations. As such, the Scout assets acquired and liabilities assumed are recorded at their acquisition-date fair values. Acquisition-related transaction costs are not included as a component of consideration transferred, but are accounted for as an expense in the period in which the costs are incurred. Any excess of the acquisition consideration over the fair value of assets acquired and liabilities assumed is allocated to goodwill, which is not deductible for tax purposes. Goodwill is attributable primarily to expected synergies and other benefits from combining Scout with the Company including the hiring of Scout's workforce.

The Company's allocation of the total purchase consideration of \$32.5 million, net of cash acquired is summarized below (in thousands)

Acquired intangible assets:			
Developed technology		\$4,330	
Customer relationships		3,400	
Trade name		1,290	
Total acquired intangible assets		9,020	
Goodwill		22,653	
Accounts receivable		2,679	
Other assets (including cash of \$211)		520	
Deferred revenue		(1,350	)
Capital lease		(283	)
Other liabilities		(477	)
Net Assets Acquired		\$32,762	

The fair value measurements for purchase price allocation were based on significant inputs that are not observable in the market and thus represent Level 3 measurements as defined in the accounting standard for fair value measurements.

The developed technology, customer relationships and trade names are being amortized on a straight-line basis over 4 years, 4 years and 4 years, respectively, with a combined weighted-average useful life of 4 years.

Pro-forma results of operations for the acquisition have not been presented because they are not material to the consolidated results of operations.

## Note 3 — Goodwill and Intangible Assets

## Intangible Assets

Intangible Assets consisted of the following:

	Three Months Ended March 31, 2014		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
	(in thousands)		
Developed technology	\$4,330	\$(213	) \$4,117
Customer relationships	3,400	(165	) 3,235
Trade name	1,290	(62	) 1,228
	\$9,020	\$(440	) \$8,580

The estimated future amortization expense of purchased intangible assets as of March 31, 2014 was as follows:



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	March 31, 2014
Years ending December 31,	
2014 (remaining nine months)	\$1,688
2015	2,255
2016	2,255
2017	2,255
2018	127
Total	\$8,580

The Company evaluates the recoverability of its long-lived assets with finite useful lives, including intangible assets, for impairment whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable. Based on the assessment of various factors in connection with the preparation of the Company's first quarter financial statements, the Company does not believe there were any negative qualitative factors impacting the recoverability of the carrying values. There were no impairment charges related to identifiable intangible assets in the three months ended March 31, 2014.

**Goodwill**

The changes in the carrying amount of goodwill by operating segment as of March 31, 2014 were as follows:

	Managed Services	Cloud and Data Services	Total
	(in thousands)		
Balance as of December 31, 2013	\$6,334	\$—	\$6,334
Addition due to acquisition	—	22,653	22,653
Balance as of March 31, 2014	\$6,334	\$22,653	\$28,987

**Note 4 — Cash, cash equivalents and short-term investments**

Cash equivalents consist of highly liquid fixed-income investments with original maturities of three months or less at the time of purchase, including money market funds. The Company has cash and cash equivalents held on its behalf by a third party of \$0.3 million and \$0.5 million as of March 31, 2014 and December 31, 2013. Short-term investments consist of readily marketable securities with a remaining maturity of more than three months from time of purchase. The Company classifies all of its cash equivalents and short-term investments as “available for sale,” as these investments are free of trading restrictions. These marketable securities are carried at fair value, with the unrealized gains and losses, net of tax, reported as accumulated other comprehensive income and included as a separate component of stockholders’ equity. Gains and losses are recognized when realized. When the Company determines that an other-than-temporary decline in fair value has occurred, the amount of the decline that is related to a credit loss is recognized in earnings. Gains and losses are determined using the specific identification method. The Company’s realized gains and losses in the three months ended March 31, 2014 and 2013 were insignificant.

Cash and cash equivalents and short-term investments consisted of the following as of March 31, 2014 and December 31, 2013 (in thousands):

March 31, 2014

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	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Cash	\$121,009	\$—	\$—	\$121,009
Cash equivalents:				
Money market mutual funds	934	—	—	934
Total cash and cash equivalents	121,943	—	—	121,943
Short-term investments:				
Corporate bonds	49,258	112	(24	) 49,346
U.S. agency securities	35,456	50	(19	) 35,487
Asset-backed securities	20,893	19	(48	) 20,864
U.S. Treasury securities	18,595	56	(10	) 18,641