SERVICESOURCE INTERNATIONAL, INC.
Form 10-Q
November 09, 2016
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2016
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 Incorporation or Organization)	(I.R.S. Employer Identification No.)
760 Market Street, 4th Floor San Francisco, California	94102
(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 x 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 x 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 x
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 x
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 October 28, 2016
Common Stock	86,934,054

Table of Contents

SERVICESOURCE INTERNATIONAL, INC.
Form 10-Q
INDEX

	Page No.
PART I. FINANCIAL INFORMATION	
Item 1. Financial Statements (unaudited)	3
Condensed Consolidated Balance Sheets as of September 30, 2016 and December 31, 2015	3
Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2016 and 2015	4
Condensed Consolidated Statements of Comprehensive Loss for the three and nine months ended September 30, 2016 and 2015	5
Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2016 and 2015	6
Notes to Unaudited Condensed Consolidated Financial Statements	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	20
Item 3. Quantitative and Qualitative Disclosures About Market Risk	33
Item 4. Controls and Procedures	33
PART II. OTHER INFORMATION	
Item 1. Legal Proceedings	34
Item 1A. Risk Factors	34
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	55
Item 3. Defaults Upon Senior Securities	55
Item 4. Mine Safety Disclosures	55
Item 5. Other Information	55
Item 6. Exhibits	55
Signatures	56
Exhibit Index	57

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements
SERVICESOURCE INTERNATIONAL, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except per share amounts)
(Unaudited)

	September 30, 2016	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	$ 51,695	$ 72,334
Short-term investments	139,178	136,378
Accounts receivable, net	54,133	56,563
Deferred income taxes	—	97
Prepaid expenses and other	6,128	8,167
Total current assets	251,134	273,539
Property and equipment, net	37,167	25,903
Deferred income taxes, net of current portion	—	1,759
Goodwill and intangibles, net	8,310	9,444
Other assets, net	5,424	6,919
Total assets	$ 302,035	$ 317,564
Liabilities and Stockholders’ Equity		
Current liabilities:		
Accounts payable	$ 1,573	$ 1,067
Accrued taxes	508	1,112
Accrued compensation and benefits	20,587	22,116
Deferred revenue	4,985	5,770
Accrued expenses	6,317	4,716
Other current liabilities	1,707	2,327
Total current liabilities	35,677	37,108
Obligations under capital leases, net of current portion	138	198
Convertible notes, net	132,515	126,051
Other long-term liabilities	6,598	6,232
Total liabilities	174,928	169,589
Commitments and contingencies (Note 8)		
Stockholders’ equity:		
Common stock; $0.0001 par value; 1,000,000 shares authorized; 87,037 shares issued and 86,916 shares outstanding as of September 30, 2016; 86,893 shares issued and 86,772 shares outstanding as of December 31, 2015	8	8
Treasury stock	(441)	(441)
Additional paid-in capital	335,355	331,922
Accumulated deficit	(207,862)	(183,941)
Accumulated other comprehensive income	47	427
Total stockholders’ equity	127,107	147,975
Total liabilities and stockholders’ equity	$ 302,035	$ 317,564

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

Table of Contents

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net revenue	$62,514	$59,432	$184,233	$187,242
Cost of revenue	40,789	42,568	122,568	131,076
Gross profit	21,725	16,864	61,665	56,166
Operating expenses:				
Sales and marketing	8,847	10,667	30,626	31,667
Research and development	1,952	3,474	6,132	12,942
General and administrative	14,638	10,912	38,233	33,778
Restructuring and other	—	(2)	—	3,737
Total operating expenses	25,437	25,051	74,991	82,124
Loss from operations	(3,712)	(8,187)	(13,326)	(25,958)
Interest expense and other, net	(2,291)	(2,513)	(5,499)	(7,097)
Impairment of cost basis equity investment	(2,300)	—	(2,300)	—
Loss before income taxes	(8,303)	(10,700)	(21,125)	(33,055)
Income tax provision	968	203	2,505	1,515
Net loss	$(9,271)	$(10,903)	$(23,630)	$(34,570)
Net loss per share, basic and diluted	$(0.11)	$(0.13)	$(0.27)	$(0.41)
Weighted average common shares outstanding, basic and diluted	86,283	85,994	85,981	85,113

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

Table of Contents

SERVICESOURCE INTERNATIONAL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(In thousands)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net loss	$(9,271)	$(10,903)	$(23,630)	$(34,570)
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	(110)	184	(1,229)	289
Unrealized gain (loss) on short-term investments, net of tax	(81)	4	849	118
Other comprehensive income (loss), net of tax	(191)	188	(380)	407
Total comprehensive loss, net of tax	$(9,462)	$(10,715)	$(24,010)	$(34,163)

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

Table of Contents

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

	Nine Months Ended September 30,	
	2016	2015
Cash flows from operating activities		
Net loss	$(23,630)	$(34,570)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	11,636	10,204
Amortization of debt discount and issuance costs	6,464	5,955
Accretion of premium on short-term investments and other	888	(205)
Deferred income taxes	1,698	1,155
Stock-based compensation	7,441	10,804
Restructuring and other	—	3,518
Impairment of cost basis equity investment	2,300	—
Changes in operating assets and liabilities:		
Accounts receivable, net	2,778	12,740
Deferred revenue	(805)	(1,043)
Prepaid expenses and other	1,306	(539)
Accounts payable	407	(620)
Accrued taxes	(627)	(879)
Accrued compensation and benefits	(1,509)	(580)
Accrued expenses	1,670	(4,031)
Other liabilities	(311)	(844)
Net cash provided by operating activities	9,706	1,065
Cash flows from investing activities		
Acquisition of property and equipment	(21,203)	(8,273)
Restricted cash	—	(1,244)
Purchases of short-term investments	(86,365)	(73,567)
Sales of short-term investments	83,331	61,430
Maturities of short-term investments	350	690
Net cash used in investing activities	(23,887)	(20,964)
Cash flows from financing activities		
Repayment on capital leases obligations	(120)	(139)
Repurchase of common stock	(8,921)	—
Proceeds from common stock issuances	5,034	3,476
Minimum tax withholding requirement	(770)	(708)
Net cash (used in) provided by financing activities	(4,777)	2,629
Net decrease in cash and cash equivalents	(18,958)	(17,270)
Effect of exchange rate changes on cash and cash equivalents	(1,681)	717
Cash and cash equivalents at beginning of period	72,334	90,382
Cash and cash equivalents at end of period	$51,695	$73,829

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

Table of Contents

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 customer and revenue lifecycle solutions that power enterprise revenue relationships, partnering with business to business technology and technology-enabled companies to optimize maintenance, support and subscription revenue streams, while also improving end customer relationships and loyalty. The Company delivers these results via dedicated service teams and integral cloud-based technologies, leveraging benchmarks and best-practices derived from its rich database of service and renewal behavior. By integrating managed services, cloud software and data, the Company provides its clients with insights into their end customers' businesses, end-to-end management and optimization of the service-contract renewals process and customer success activities, including data management, quoting, selling and recurring revenue business intelligence. The Company receives commissions from its clients based on renewal sales that the Company generates on their behalf under a pay-for-performance or flat-rate model. In addition, the Company also provides a purpose-built cloud application to maximize the renewal of subscriptions, maintenance and support contracts and receives subscription fees from its clients. The Company's corporate headquarters is located in San Francisco, California. The Company has additional U.S. offices in Colorado, Tennessee and Washington, and international offices in Bulgaria, Ireland, Japan, Malaysia, the Philippines, Singapore and the United Kingdom.

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 and the instructions to Form 10-Q and Article 10 of Regulation S-X, without audit. Accordingly, they do not include all of the information required by U.S. GAAP for annual financial statements. The unaudited condensed consolidated balance sheet as of December 31, 2015 has been derived from the Company's audited annual consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2015 filed with the Securities and Exchange Commission ("SEC") on March 8, 2016. 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, 2015, 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 the Company's financial position, operating results, and cash flows for the interim periods presented. Preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the Company's condensed consolidated financial statements and accompanying notes. Actual results could differ materially from those estimates. Also, the results for the interim periods are not necessarily indicative of results for the entire year.

The Company's Chief Executive Officer ("CEO") is its chief operating decision maker. The CEO historically managed the Company as two reportable segments: Managed Services and Cloud and Business Intelligence ("CBI") based on the discrete financial information available for each segment. However, during the second half of 2015, the Company began implementing a series of actions to emphasize a one-company, single go-to-market strategy for its services offering that resulted in the reorganization of its CBI personnel and sales team delivery structure. The objective of these actions was to more closely integrate and support the Managed Services organization with the Company's cloud technologies and to eliminate new stand-alone CBI cloud offerings. Further, due to this reorganization and shift to a single go-to-market strategy, discrete cost information was no longer separately available for the former CBI segment. Consequently, beginning in the first quarter of 2016, the CEO manages and allocates resources on a company-wide basis as a single segment that is focused on service offerings which integrate data, processes and cloud technologies.

7

Table of Contents

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standard Board ("FASB") issued Accounting Standard Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606), which supersedes the revenue recognition requirements in the FASB's Accounting Standards Codification ("ASC") 605, Revenue Recognition. This ASU is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. In July 2015, the FASB approved a one year deferral of the effective date to December 15, 2017, and early application would be permitted, but not before the original effective date of December 15, 2016, so the effective date will be the first quarter of fiscal year 2018 using one of two retrospective application methods. The Company is currently evaluating the impact ASU No. 2014-09 will have on its consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-05, Intangibles - Goodwill and Other - Internal Use Software, which provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, the update specifies that the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. The update further specifies that the customer should account for a cloud computing arrangement as a service contract if the arrangement does not include a software license. ASU No. 2015-05 is effective for the Company in fiscal year 2016. An entity can elect to adopt the amendments either (1) prospectively to all arrangements entered into or materially modified after the effective date or (2) retrospectively. The Company has historically accounted for its cloud computing arrangements as a service contract. Consequently, adoption of ASU No. 2015-05 had no impact on the Company's consolidated financial statements.

In November 2015, the FASB issued ASU No. 2015-17, Balance Sheet Classification of Deferred Taxes, which requires that deferred tax assets and liabilities to be classified as noncurrent in the consolidated balance sheet. The standard will be effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted for financial statements that have not been previously issued. The standard may be applied either prospectively to all deferred tax assets and liabilities or retrospectively to all periods presented. The Company is currently evaluating the impact that adoption of ASU No. 2015-17 will have on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02 Leases (Topic 842). This standard requires entities that lease assets to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. The standard is effective for fiscal years and the interim periods within those fiscal years beginning after December 15, 2018. The guidance is required to be applied by the modified retrospective transition approach. Early adoption is permitted. The Company is currently evaluating the impact of the adoption of this authoritative guidance on its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, Compensation—Stock Compensation (Topic 718). The standard is intended to simplify several areas of accounting for share-based compensation arrangements, including the income tax impact, classification on the statement of cash flows and accounting for award forfeitures. ASU 2016-09 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016, and early adoption is permitted. The Company early adopted ASU 2016-09 during the third quarter of 2016 on a modified retrospective basis for the income statement impact of forfeitures and income taxes. Accordingly, the Company recognized a cumulative adjustment charge of $0.3 million to beginning Accumulated Deficit as of January 1, 2016 related to the forfeiture rate methodology change. ASU 2016-09 also requires the presentation of excess tax benefits as an operating

activity (combined with other income tax cash flows) on the statement of cash flows rather than as a financing activity. Adopting this provision of the ASU did not have a material impact on the Company's financial statements. The new guidance also requires the presentation of shares withheld for employee taxes as a financing activity (retrospective change) on the statement of cash flows which resulted in a $0.8 million and $0.7 million reclassification from operating activities to financing activities for the nine month period ending September 30, 2016 and 2015, respectively.

Reclassifications

Amounts shown in Other assets, net, on the Consolidated Balance Sheet as of December 31, 2015 have been reclassified to Convertible notes, net, to reflect the current period presentation as a result of the adoption of ASU No. 2015-03, Simplifying the Presentation of Debt Issuance Cost, which requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. See Note 7 - Debt.

Table of Contents

Correction to Condensed Consolidated Balance Sheet as of December 31, 2015

Subsequent to the issuance of the Company's 2015 consolidated financial statements, management determined that its net deferred tax asset valuation allowance was incorrectly computed and recorded for the periods ending December 31, 2012, 2013, 2014 and 2015 and March 31, 2016. This error was due to the incorrect netting of an indefinite-lived deferred tax liability related to tax-deductible goodwill against certain deferred tax assets that the Company believed more likely than not would not be realized. In order to be a source of future taxable income to support realizability of a deferred tax asset, a taxable temporary difference must reverse in a period such that it would result in the realization of the deferred tax asset. Taxable temporary differences related to indefinite-lived intangibles and tax-deductible goodwill are problematic in this regard as, by their nature, they are not predicted to reverse (commonly referred to as naked credits). While such temporary differences would reverse on impairment or sale of the related assets, those events are not anticipated under ASC 740 Income taxes ("ASC 740") for purposes of predicting the reversal of the related taxable temporary difference. As a result, the reversal of taxable temporary differences with respect to indefinite-lived assets and tax-deductible goodwill should not be considered a source of future taxable income when evaluating and calculating a valuation allowance in accordance with ASC 740. The cumulative error beginning in 2012, totaled $2.2 million at March 31, 2016 and $2.1 million at December 31, 2015.

In evaluating whether the previously issued financial statements were materially misstated, the Company followed the guidance of ASC 250, Accounting Changes and Error Corrections, SEC Staff Accounting Bulletin ("SAB") Topic 1.M, Assessing Materiality, and SAB Topic 1.N, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements. The Company concluded that the error was not material to the affected prior periods. However, correction of the entire cumulative error would have been material to that quarter's three and six months results and would have impacted comparisons to prior quarters. As a result, certain amounts presented in the Company's condensed consolidated financial statements have been revised from the amounts previously reported to correct this error as shown in the table below and as included elsewhere in this Quarterly Report on Form 10-Q for the period ended September 30, 2016.

Condensed Consolidated Balance Sheet as of December 31, 2015 (in thousands):

	As Previously Reported	Corrections	As Revised
Other long term liabilities	$ 4,113	$ 2,119	$ 6,232
Total liabilities	167,470	2,119	169,589
Accumulated deficit	(181,822)	(2,119)	(183,941)
Total stockholders' equity	150,094	(2,119)	147,975
Total liabilities and stockholders' equity	317,564	—	317,564

Correction to Condensed Consolidated Statements of Operations, Comprehensive Income (Loss) and Cash Flows for the periods ended September 30, 2015

The Company has restated certain amounts in the condensed consolidated statements of operations and comprehensive income for the three and nine months ended September 30, 2015 and the condensed consolidated statement of cash flows for the nine months ended September 30, 2015 to correct income tax expense related to the valuation allowance calculation error discussed above, so that such adjustment is recorded in the proper period. The Company believes this correction is not material to its previously issued annual and interim consolidated financial statements.

The effects of correcting the valuation allowance calculation error are as follows:

- Additional income tax expense of $0.1 million and $0.1 million in the three and nine months ended September 30, 2015, respectively, has been recorded;
- Net loss increases $0.1 million and $0.1 million in the three and nine months ended September 30, 2015, respectively; and
- Net loss per share, basic and diluted remain unchanged for the three months ended September 30, 2015 and increases from $0.40 to $0.41 for the nine months ended September 30, 2015.

Table of Contents

The following tables summarize the effects of the correction on the Company's condensed consolidated statements of operations for three and nine months ended September 30, 2015 (in thousands):

	For the Three Months Ended September 30, 2015		
	As Previously Reported	Corrections	As Revised
Loss before income taxes	$(10,700)	$ —	$(10,700)
Income tax provision	158	45	203
Net loss	$(10,858)	$ (45)	$(10,903)
Net loss per share, basic and diluted	$(0.13)	$ —	$(0.13)
Weighted average common shares outstanding, basic and diluted	85,994	—	85,994

	For the Nine Months Ended September 30, 2015		
	As Previously Reported	Corrections	As Revised
Loss before income taxes	$(33,055)	$ —	$(33,055)
Income tax provision	1,380	135	1,515
Net loss	$(34,435)	$ (135)	$(34,570)
Net loss per share, basic and diluted	$(0.40)	$ (0.01)	$(0.41)
Weighted average common shares outstanding, basic and diluted	85,113		85,113

The following tables summarize the effects of the corrections on the Company's condensed consolidated statements of comprehensive income for the three and nine months ended September 30, 2015 (in thousands):

	For the Three Months Ended September 30, 2015		
	As Previously Reported	Corrections	As Revised
Net loss	$(10,858)	$ (45)	$(10,903)
Other comprehensive income (loss):			
Foreign currency translation adjustments	184	—	184
Unrealized gain (loss) on short-term investments	4	—	4
Other comprehensive income (loss)	188	—	188
Total comprehensive loss	$(10,670)	$ (45)	$(10,715)

	For the Nine Months Ended September 30, 2015		
	As Previously Reported	Corrections	As Revised
Net loss	$(34,435)	$ (135)	$(34,570)
Other comprehensive income (loss):			
Foreign currency translation adjustments	289	—	289
Unrealized gain (loss) on short-term investments	118	—	118
Other comprehensive income (loss)	407	—	407
Total comprehensive loss	$(34,028)	$ (135)	$(34,163)

10

Table of Contents

The following tables summarize the effects of the corrections on the Company’s condensed consolidated statement of cash flows for the nine months ended September 30, 2015 (in thousands):

	For the Nine Months Ended September 30, 2015		
Cash flows from operating activities	As Previously Reported	Corrections	As Revised
Net loss	$(34,435)	$ (135)	$(34,570)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Depreciation and amortization	10,204	—	10,204
Amortization of debt discount and issuance costs	5,955	—	5,955
Accretion of premium on short-term investments and other	(205)	—	(205)
Deferred income taxes	1,020	135	1,155
Stock-based compensation	10,804	—	10,804
Restructuring and other	3,518	—	3,518
Changes in operating assets and liabilities:			
Accounts receivable, net	12,740	—	12,740
Deferred revenue	(1,043)	—	(1,043)
Prepaid expenses and other	(539)	—	(539)
Accounts payable	(620)	—	(620)
Accrued taxes	(879)	—	(879)
Accrued compensation and benefits	(580)	—	(580)
Accrued expenses	(4,031)	—	(4,031)
Other liabilities	(844)	—	(844)
Net cash provided by operating activities	$1,065	$ —	$1,065

Note 2 — 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. 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 and are available for use in the Company's daily operations. 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 other-than-temporary declines in fair value have 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 and nine months ended September 30, 2016 and 2015 were insignificant.

Cash and cash equivalents and short-term investments consisted of the following as of September 30, 2016 and December 31, 2015 (in thousands):

Table of Contents

September 30, 2016

	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Cash	$ 51,677	$ —	$ —	$ 51,677
Cash equivalents:				
Money market mutual funds	18	—	—	18
Total cash and cash equivalents	51,695	—	—	51,695
Short-term investments:				
Corporate bonds	54,902	147	(39)	55,010
U.S. agency securities	33,526	110	(8)	33,628
Asset-backed securities	27,792	74	(2)	27,864
U.S. Treasury securities	22,708	9	(41)	22,676
Total short-term investments	138,928	340	(90)	139,178
Cash, cash equivalents and short-term investments	$ 190,623	$ 340	$ (90)	$ 190,873

December 31, 2015

	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Cash	$ 72,105	$ —	$ —	$ 72,105
Cash equivalents:				
Money market mutual funds	229	—	—	229
Total cash and cash equivalents	72,334	—	—	72,334
Short-term investments:				
Corporate bonds	54,434	—	(389)	54,045
U.S. agency securities	36,010	—	(187)	35,823
Asset-backed securities	30,665	—	(132)	30,533
U.S. Treasury securities	16,024	—	(47)	15,977
Total short-term investments	137,133	—	(755)	136,378
Cash, cash equivalents and short-term investments	$ 209,467	$ —	$ (755)	$ 208,712

The following table summarizes the amortized cost and estimated fair value of money market mutual funds and short-term fixed income securities classified as short-term investments based on stated maturities as of September 30, 2016 (in thousands):

	Amortized Cost	Estimated Fair Value
Less than 1 year	$ 19,435	$ 19,433
Due in 1 to 3 years	119,511	119,763
Total	$ 138,946	$ 139,196

As of September 30, 2016, the Company did not consider any of its investments to be other-than-temporarily impaired.

Note 3 — Fair Value of Financial Instruments

The Company measures certain financial instruments at fair value on a recurring basis. The Company uses a three-tier fair value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1 valuations are based on quoted prices in active markets for identical assets or liabilities.

Table of Contents

Level 2 valuations are based on inputs that are observable, either directly or indirectly, other than quoted prices included within Level 1. Such inputs used in determining fair value for Level 2 valuations include quoted prices in active markets for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
Level 3 valuations are based on information that is unobservable and significant to the overall fair value measurement.
All of the Company's cash equivalents and short-term investments are classified within Level 1 or Level 2.
The following table presents information about the Company's financial instruments that are measured at fair value as of September 30, 2016 and indicates the fair value hierarchy of the valuation (in thousands):

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Cash equivalents:			
Money market mutual funds	$18	$ 18	$ —
Total cash equivalents	18	18	—
Short-term investments:			
Corporate bonds	55,010	—	55,010
U.S. agency securities	33,628	—	33,628
Asset-backed securities	27,864	—	27,864
U.S. Treasury securities	22,676	—	22,676
Total short-term investments	139,178	—	139,178
Cash equivalents and short-term investments	$139,196	$ 18	$ 139,178

The Company has restricted cash of $1.2 million within Other assets, net as of September 30, 2016 and December 31, 2015. The restricted cash is classified within Level 1.
The following table presents information about the Company's financial instruments that are measured at fair value as of December 31, 2015 and indicates the fair value hierarchy of the valuation (in thousands):

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Cash equivalents:			
Money market mutual funds	$229	$ 229	$ —
Total cash equivalents	229	229	—
Short-term investments:			
Corporate bonds	54,045	—	54,045
U.S. agency securities	35,823	—	35,823
Asset-backed securities	30,533	—	30,533
U.S. Treasury securities	15,977	—	15,977
Total short-term investments	136,378	—	136,378
Cash equivalents and short-term investments	$136,607	$ 229	$ 136,378

13

Table of Contents

The convertible notes issued by the Company in August 2013 are shown on the accompanying consolidated balance sheets at their original issuance value, net of unamortized discount, and are not marked to market each period. The approximate fair value of the convertible notes as of September 30, 2016 and December 31, 2015 was $143.6 million and $126.0 million, respectively. The fair value of the convertible notes was determined using quoted market prices for similar securities, which, due to limited trading activity, are considered Level 2 in the fair value hierarchy.
The Company did not have any other financial instruments or long-term debt measured at fair value as of September 30, 2016 and December 31, 2015.

Note 4 — Other Assets, Net

Other assets, net balances were comprised of the following (in thousands):

	September 30, 2016	December 31, 2015
Restricted Cash	$ 1,244	$ 1,244
Cost basis equity investment	2,200	4,500
Long-term deposits and other	1,980	1,175
Total	$ 5,424	$ 6,919

In 2013, the Company made an equity investment in a private company for $4.5 million, which represented less than 5% of the outstanding equity of that company. The Company carries this investment on a cost basis and periodically evaluate its recoverability to determine if there is an impairment in the carrying value. Based on unfavorable growth trends and declining financial performance of this private company, the Company determined that its investment was impaired at September 30, 2016 and recorded a $2.3 million impairment charge during the three and nine month periods ending September 30, 2016.

Note 5 — Other Current Liabilities

Other current liabilities balances were comprised of the following (in thousands):

	September 30, 2016	December 31, 2015
Accrued Interest - Convertible Notes	$ 375	$ 948
Deferred Rent	1,061	738
ESPP Withholding	271	641
Total	$ 1,707	$ 2,327

Note 6 — Credit Facility and Capital Leases

Letter of Credit

On February 3, 2015, the Company issued a $1.2 million letter of credit in connection with a lease for a new San Francisco facility. The letter of credit is secured by $1.2 million of a money market account which is classified as restricted cash in other assets, net, in the accompanying condensed consolidated balance sheets.

Capital Leases

The Company has capital lease agreements totaling $0.2 million that are collateralized by the underlying property and equipment and expire through September 2019. The weighted-average imputed interest rates for the capital lease agreements were 2.9% and 4.9% at September 30, 2016 and 2015, respectively.

Note 7 — Debt

Senior Convertible Notes

In August 2013, the Company issued senior convertible notes (the “Notes”) in exchange for gross proceeds of $150.0 million.

The Notes are governed by an Indenture, dated August 13, 2013 (the “Indenture”), between the Company and Wells Fargo Bank, National Association, as trustee. The Notes will mature on August 1, 2018, unless earlier repurchased or converted, and bear interest at a rate of 1.50% per year payable semi-annually in arrears on February 1 and August 1, beginning February 1, 2014.

The Notes are convertible at an initial conversion rate of 61.6770 of common stock per $1,000 principal amount of Notes, which represents an initial conversion price of approximately $16.21 per share of common stock, subject to anti-dilution adjustments upon certain specified events as defined in the Indenture. Upon conversion, the Notes will be settled in cash, shares of the Company’s common stock, or any combination thereof, at the Company’s option.

Prior to February 1, 2018, the Notes are convertible only upon the following circumstances:

- during any calendar quarter commencing after December 31, 2013, (and only during such calendar quarter), if for at least 20 trading days (whether or not consecutive) during the period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter, the last reported sale price of common stock on such trading day is greater than or equal to 130% of the applicable conversion price on such trading day;
- during the five business day period after any five consecutive trading day period in which the trading price per $1,000 principal amount of the Notes for each trading day of that five consecutive trading day period was less than 98% of the product of the last reported sale price of common stock and the applicable conversion rate on each such trading day; or
- upon the occurrence of specified corporate events described in the Indenture.

Holders of the Notes may convert their Notes at any time on or after February 1, 2018, until the close of business on the second schedule trading day immediately preceding the maturity date, regardless of the foregoing circumstances.

The holders of the Notes may require the Company to repurchase all or a portion of their Notes at a cash repurchase price equal to 100% of the principal amount of the Notes being repurchased, plus accrued and unpaid interest, if any, upon a fundamental change as defined in the Indenture. In addition, upon certain events of default as defined in the Indenture, the trustee, or the holders of at least 25% in principal amount of the outstanding Notes may declare 100% of the principal amount of the Notes, plus accrued and unpaid interest, if any, on all the Notes to be due and payable. In case of certain events of bankruptcy, insolvency or reorganization involving the Company, 100% of the principal of and accrued and unpaid interest on the Notes will automatically become due and payable. The Notes were not subject to conversion or repurchase at September 30, 2016.

To account for the Notes at issuance, the Company separated the Notes into debt and equity components pursuant to the accounting standards for convertible debt instruments that may be fully or partially settled in cash upon conversion. The fair value of debt component was estimated using an interest rate for nonconvertible debt, with terms similar to the Notes, excluding the conversion feature. The carrying amount of the liability component was calculated by measuring the fair value of a similar liability that does not have an associated convertible feature. The excess of the principal amount of the Notes over the fair value of the debt component was recorded as a debt discount and a corresponding increase in additional paid-in capital. The debt discount is accreted to interest expense over the term of the Notes using the interest method. The amount recorded to additional paid-in capital is not to be remeasured as long as it continues to meet the conditions of equity classification. Upon issuance of the $150.0 million of Notes, the Company recorded $111.5 million to debt and $38.5 million to additional paid-in capital.

The Company incurred transaction costs of approximately $4.9 million related to the issuance of the Notes. In accounting for these costs, the Company allocated the costs to the debt and equity components in proportion to the allocation of proceeds from the issuance of the Notes to such components. Transaction costs allocated to the debt component of $3.6 million were recorded as a deferred asset in other assets, net, and amortized to interest expense over the term of the Notes. As a result of the adoption of ASU No. 2015-03, Simplifying the Presentation of Debt Issuance Cost, these costs were reclassified to Convertible Notes, net, as of December 31, 2015. The transaction costs allocated to the equity component of $1.3 million were recorded to additional paid-in capital.

The net carrying amount of the liability component of the Notes consists of the following (in thousands):

	September 30, 2016	December 31, 2015
Principal amount	$ 150,000	$ 150,000
Unamortized debt discount	(15,995)	(21,908)

Unamortized debt issuance costs	(1,490)	(2,041)
Net carrying amount	$ 132,515	$ 126,051

The following table presents the interest expense recognized related to the Notes (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Contractual interest expense at 1.5% per annum	$563	$563	$1,688	$1,688
Amortization of debt issuance costs	189	174	551	507
Accretion of debt discount	2,028	1,877	5,913	5,448
Total	$2,780	$2,614	$8,152	$7,643

The net proceeds from the Notes were approximately $145.1 million after payment of the initial purchasers' discount and offering expense. The Company used approximately $31.4 million of the net proceeds from the Notes to pay the cost of the Note Hedges described below, which was partially offset by $21.8 million of the proceeds from the Company's sale of the Warrants also described below.

Note Hedges

Concurrent with the issuance of the Notes, the Company entered into note hedges ("Note Hedges") with certain bank counterparties, with respect to its common stock. The Company paid $31.4 million for the Note Hedges. The Note Hedges cover approximately 9.25 million shares of the Company's common stock at a strike price of $16.21 per share. The Note Hedges will expire upon the maturity of the Notes. The Note Hedges are intended to reduce the potential dilution to the Company's common stock upon conversion of the Notes and/or offset the cash payment in excess of the principal amount of the Notes the Company is required to make in the event that the market value per share of the Company's common stock at the time of exercise is greater than the conversion price of the Notes.

Warrants

Separately, the Company entered into warrant transactions, whereby it sold warrants to the same bank counterparties as the Note Hedges to acquire approximately 9.25 million shares of the Company's common stock at an initial strike price of $21.02 per share ("Warrants"), subject to anti-dilution adjustments. The Company received proceeds of approximately $21.8 million from the sale of the Warrants. If the fair value per share of the Company's common stock exceeds the strike price of the Warrants, the Warrants will have a dilutive effect on earnings per share, unless the Company elects, subject to certain conditions, to settle the Warrants in cash.

The amounts paid and received for the Note Hedges and the Warrants have been recorded in additional paid-in capital. The fair value of the Note Hedges and the Warrants are not remeasured through earnings each reporting period.

Note 8 — Commitments and Contingencies

Operating Leases

The Company leases its office space and certain equipment under noncancelable operating lease agreements with various expiration dates through November 30, 2022. Rent expense for the three months ended September 30, 2016 and 2015 was $2.9 million and $2.3 million, respectively, and for the nine months ended September 30, 2016 and 2015 was $8.3 million and $7.0 million, respectively. The Company recognizes rent expense on a straight-line basis over the lease period and accrues for rent expense incurred but not paid.

In April 2016, the Company signed a 6-year office lease expiring in July 2022, for a new international sales center in Singapore to occupy 17,626 square feet. The total minimum lease payments are estimated to be approximately $4.8 million over the lease term.

In July 2016, the Company signed a 5-year office lease expiring in December 2021, for an additional floor in the existing service delivery center in the Philippines to occupy 21,915 square feet. The total minimum lease payments are estimated to be approximately $3.5 million over the lease term.

Table of Contents

Litigation

The Company is subject to various legal proceedings and claims arising in the ordinary course of our business, including the cases discussed below. Although the results of litigation and claims cannot be predicted with certainty, the Company is currently not aware of any litigation or threats of litigation in which the final outcome could have a material adverse effect on our business, operating results, financial position, or cash flows. Regardless of the outcome, litigation can have an adverse impact on the Company because of defense and settlement costs, diversion of management resources, if multiple actions are resolved in the same time period, and other factors. The Company records a contingent liability when it is probable that a loss has been incurred and the amount is reasonably estimable in accordance with accounting for contingencies. As of September 30, 2016, the Company has accrued a $1.5 million reserve relating to our potential liability for currently pending disputes, reflected in Accrued Expenses in the accompanying condensed consolidated balance sheets and notes to our financial statements.

On July 8, 2015, a single plaintiff filed a putative securities class action lawsuit, Weller v. ServiceSource International, Inc. et al., in the U.S. District Court for the Northern District of California (the “Weller Lawsuit”) against the Company and the Company’s former Chief Executive Officer. The Weller Lawsuit was brought on behalf of purchasers of Company stock during the period January 22, 2014 through May 1, 2014, and alleges violations under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). In connection with the mandatory lead plaintiff appointment process under the Private Securities Litigation Reform Act (PSLRA), various law firms issued press releases between July 2015 and September 2015 to search for additional shareholders that would be willing to serve as lead plaintiffs in this lawsuit. This solicitation period ended on September 29, 2015 and no other shareholders came forward, leaving only the named plaintiff as the sole shareholder seeking to be appointed lead plaintiff. The court appointed Weller a lead plaintiff on October 21, 2015. At this time, no motion to certify a class has been filed. The Company believes that the claims are meritless, and will vigorously defend itself against such claims. On December 9, 2015, the Company filed a motion to dismiss the Weller Lawsuit. The motion has been fully briefed, and the parties are awaiting a ruling from the court.

On August 23, 2016, the United States District Court for the Middle District of Tennessee granted conditional class certification in a lawsuit originally filed on September 21, 2015 by three former senior sales representatives. The lawsuit, Sarah Patton, et al v. ServiceSource Delaware, Inc., asserts a claim under the Fair Labor Standards Act (“FLSA”) alleging that certain sales account representatives and senior sales representatives in our Nashville location were not paid for all hours worked and were not properly paid for overtime hours worked. The complaint also asserts claims under Tennessee state law for breach of contract and unjust enrichment, however, the plaintiffs have not yet filed a motion to certify the state law breach of contract and unjust enrichment claims as a class action. Beginning October 31, 2016, notice was provided to potential FLSA claim class members, who have through December 30, 2016 to opt in to the class. The Company will continue to vigorously defend itself against these claims.

Note 9 — Share Repurchase Program, Stock-Based Compensation and ESPP

In August 2015, the Board authorized a stock repurchase program (the "program") with a maximum authorization to repurchase up to $30.0 million worth of common stock of the Company. The program expires in August 2017. The aggregate amount available under the program was approximately $19.9 million as of September 30, 2016. The share repurchase program does not obligate the Company to acquire any specific number of shares. Under the program, shares may be repurchased in privately negotiated and/or open market transactions, including under plans complying with Rule 10b5-1 under the Exchange Act. The Company cash settles with the program broker periodically and reflects any unsettled amounts as a current liability at each period end.

Table of Contents

The following shares of common stock were repurchased under the above-described repurchase plan:

	Number of Shares (in thousands)	Weighted Average Repurchase Price Per Share	Amount (includes commissions) (in thousands)
2016:			
Third quarter	—	$ —	$ —
Second quarter	428	3.88	1,661
First quarter	1,835	3.96	7,260
2015:			
Fourth quarter	136	$ 4.09	$ 557
Third Quarter	159	4.12	655
Total common stock repurchases under the program	2,558		$ 10,133

The following table summarizes the consolidated stock-based compensation expense included in the condensed consolidated statements of operations (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Cost of revenue	$299	$704	$1,146	$2,200
Sales and marketing	565	796	2,152	2,443
Research and development	106	322	448	1,314
General and administrative	1,276	1,438	3,695	4,847
Total stock-based compensation	$2,246	$3,260	$7,441	$10,804

The above table does not include $0.1 million and $0.4 million of capitalized stock-based compensation related to internal-use software during the three and nine months ended September 30, 2016. There was no capitalized stock-based compensation related to internal-use software during the three and nine months ended September 30, 2015.

Determining Fair Value of Stock Awards

The Company estimates the fair value of stock option awards at the date of grant using the Black-Scholes option-pricing model. This model requires us to make estimates and assumptions including, among other things, estimates regarding the length of time an employee will retain vested stock options before exercising them, the estimated volatility of our common stock price using peer company volatility and the number of options that will be forfeited prior to vesting. Prior to January 1, 2016, the expected stock price volatility assumption was determined by examining the historical volatilities for industry peers. Effective January 1, 2016, the stock price volatility assumption was determined by examining a blend of the historical volatilities for industry peers and the trading history for the Company's common stock. Options are granted with an exercise price equal to the fair value of the common stock as of the date of grant. Compensation expense is amortized net of actual forfeitures during the period on a straight-line basis over the requisite service period of the options, which is generally four years. Restricted stock, upon vesting, entitles the holder to one share of common stock for each restricted stock unit or award, and has a purchase price of $0.0001 per share, which is equal to the par value of the Company's common stock, and vests over four years. The fair value of the restricted stock is based on the Company's closing stock price on the date of grant, and compensation expense net of actual forfeitures during the period is recognized on a straight-line basis over the vesting period.

Equity Incentive Plan

During the third quarter of 2016, the Company granted performance-based restricted stock unit awards under the Company's 2011 Equity Incentive Plan to certain key executives (the "2016 PSU Awards"). For each 2016 PSU Award, a number of restricted stock units will become eligible to vest based on the levels of achievement of the performance-based conditions described below, and any such restricted stock units that become eligible to vest will vest upon the satisfaction of the time-based vesting condition described below. The aggregate target number of restricted stock units subject to the 2016 PSU Awards is 1.0 million with an aggregate grant date fair value of $5.1 million, which will be expensed over a two year period.

Table of Contents

The performance-based conditions are based upon the Company's revenue and adjusted EBITDA performance in fiscal year 2016 against the target goals for such metrics under the Company's 2016 corporate incentive plan (in each case, "Performance Achievement"), which will each be determined on the date the Company files its Annual Report on Form 10-K for fiscal year 2016. The target number of restricted stock units for each 2016 PSU Award will be divided equally between the two performance metrics. For each performance metric, the number of restricted stock units that become eligible to vest will be: (i) if the applicable Performance Achievement is less than 85% of the target goal, no restricted stock units for such performance metric, (ii) if the applicable Performance Achievement is equal to 85% of the target goal, 50% of the target number of restricted stock units for such performance metric, (iii) if the applicable Performance Achievement is equal to 100% of the target goal, 100% of the target number of restricted stock units for such performance metric, or (iv) if the applicable Performance Achievement is at least 120% of the target goal, 150% of the target number of restricted stock units for such performance metric. For each performance metric, if the applicable Performance Achievement falls between any of the thresholds (ii), (iii), and (iv) specified in the previous sentence, the number of restricted stock units that become eligible to vest for such performance metric will be determined via linear interpolation.

Under the time-based vesting condition, 50% of the restricted stock units that have become eligible to vest will vest on the first anniversary of the grant date, and 50% of the restricted stock units that have become eligible to vest will vest on the second anniversary of the grant date, except as otherwise provided under certain termination and change-in-control provisions in each award agreement governing a 2016 PSU Award. Such provisions will determine the number of restricted stock units that become eligible to vest and when and how many restricted stock units will actually vest in connection with the specified terminations of employment and changes in-control.

Option and restricted stock activity under the 2011 Equity Incentive Plan for the nine months ended September 30, 2016 was as follows (shares in thousands):

		Options Outstanding		Restricted Stock Outstanding
	Shares and Units Available for Grant	Number of Shares	Weighted-Average Exercise Price	Number of Shares
Outstanding — December 31, 2015	7,055	10,616	$ 4.79	4,552
Additional shares reserved under the 2011 equity incentive plan	3,478	—	—	—
Granted	(2,781)	638	4.04	2,143
Options exercised/ Restricted stock released		(932)	4.21	(1,331)
RSU shares withheld for taxes	177	—	—	176
Canceled/Forfeited	2,470	(1,381)	5.41	(1,089)
Outstanding — September 30, 2016	10,399	8,941	$ 4.70	4,451

The weighted average grant-date fair value of employee stock options granted during the three months ended September 30, 2016 and 2015 was $2.30 and $1.71 per share, respectively, and $2.03 and $1.44 for the nine months ended September 30, 2016 and 2015, respectively. The unamortized grant date fair value of both stock options and restricted stock awards totaled $24.8 million at September 30, 2016.

Employee Stock Purchase Plan

The Company's 2011 Employee Stock Purchase Plan (the "ESPP") is intended to qualify under Section 423 of the Internal Revenue Code of 1986. Under the ESPP, employees are eligible to purchase common stock through payroll deductions of up to 10% of their eligible compensation, subject to any plan limitations. The purchase price of the shares on each purchase date is equal to 85% of the lower of the fair market value of the Company's common stock on the first and last trading days of each 12-month offering period.

Table of Contents

The ESPP provides that additional shares are reserved under the plan annually on the first day of each fiscal year in an amount equal to the lesser of (i) 1.5 million shares, (ii) one percent of the outstanding shares of common stock on the last day of the immediately preceding fiscal year, or (iii) an amount determined by the board of directors and/or the compensation committee of the board of directors. On January 1, 2016, approximately 0.9 million additional shares were reserved under the ESPP pursuant to the plan's automatic increase provision. As of September 30, 2016, 1.8 million total shares had been issued under the ESPP and 3.1 million shares were available for future issuance.

Note 10 — Income Taxes

The Company is subject to taxation in the United States and various state and foreign jurisdictions. Earnings from non-U.S. activities are subject to local country income tax. The Company computes its quarterly income tax provision by using a forecasted annual effective tax rate and adjusts for any discrete items arising during the quarter. The primary difference between the effective tax rate and the federal statutory tax rate relates to the valuation allowances on the Company’s net operating losses and foreign tax rate differences. The tax years 2010 through 2016 remain subject to examination by federal, state and foreign tax authorities.

For the three and nine months ended September 30, 2016, the Company recorded income tax expense of $1.0 million and $2.5 million, respectively. This amount primarily consists of income and withholding taxes for foreign and state jurisdictions where the Company has profitable operations, as well as valuation allowance adjustments for certain U.S. tax jurisdictions. No tax benefit was provided for losses incurred in United States and Singapore because those losses are offset by a full valuation allowance.

The gross amount of the Company's unrecognized tax benefits was $0.9 million as of September 30, 2016 and December 31, 2015, none of which, if recognized, would affect the Company’s effective tax rate.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

This report, including Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A"), includes estimates, projections, statements relating to our business plans, objectives, and expected operating results that are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements may appear throughout this report, including this: “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and “Risk Factors.” These forward-looking statements generally are identified by the words “believe,” “project,” “expect,” “anticipate,” “estimate,” “intend,” “strategy,” “future,” “opportunity,” “ “should,” “will,” “would,” “will be,” “will continue,” “will likely result,” and similar expressions. Forward-looking statements based on current expectations and assumptions that are subject to risks and uncertainties that may cause actual results to differ materially. We describe risks and uncertainties that could cause actual results and events to differ materially in “Risk Factors” (Part II, Item 1A of this Form 10-Q), “Quantitative and Qualitative Disclosures about Market Risk” (Part I, Item 3 of this Form 10-Q), and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” (Part I, Item 2 of this Form 10-Q). We undertake no obligation to update or revise publicly any forward-looking statements, whether because of new information, future events, or otherwise.

All dollar amounts expressed as numbers in this MD&A are in millions unless otherwise noted.

OVERVIEW

ServiceSource International, Inc. (NASDAQ: SREV) is the global leader in customer and revenue lifecycle solutions that power enterprise revenue relationships. Based on the science of Revenue Lifecycle Management ("RLM"), ServiceSource provides some of the world's leading business to business ("B2B") companies with expert, technology-enabled services and solutions that are proven to grow and retain revenue from existing customers, directly or through a channel. With a holistic approach to managing the entire revenue lifecycle (which includes onboarding, client success, quoting, up-sell, cross-sell, warranty services and renewals), ServiceSource solutions help drive improved customer adoption, expansion and retention for our B2B clients.

Our solutions are comprised of a unique and precise mix of managed services, a purpose-built RLM technology platform and best-practice processes developed over more than 17 years of exclusive focus on revenue retention, revenue growth and customer success. With the experience of nearly $8.4 billion in recurring revenue sold in 2015 and global deployments across 40 languages and 200 countries, ServiceSource solutions can uniquely leverage

industry and company data, leading-edge technology and best-practices drawn from our significant and in-depth database of renewal benchmarks. By integrating managed services, cloud software and data, we provide our clients with insights into their end customers' businesses, end-to-end management and optimization of end customer onboarding, adoption, subscription, asset management, and service contract renewal processes whether managed by us directly or through our client's channel partners.

Table of Contents

Our managed services offering leverages either a pay-for-performance or a flat-rate model whereby our clients pay us a commission based on renewal sales that we generate on their behalf. Our cloud software technologies are an integral component to our unique RLM technology platform and may be managed by ServiceSource or provided directly to the client. Such cloud technologies include: ServiceSource Revenue Analytics, Renew OnDemand and the ServiceSource Customer Success application, all of which automate and provide data driven insights into these highly valuable but typically manual business processes. This blend of technology capabilities, managed services and best-practice process can drive higher subscription, maintenance and support revenue while improving customer retention and increasing business predictability.

The scalability of our solution enables us to sell in over 40 languages from six centers around the globe. Our solution is designed to optimize recurring revenue across different revenue models, distribution models, and segments, including hardware, software, SaaS, industrial systems, information and media, as well as technology-enabled health care and life sciences.

Our Chief Executive Officer ("CEO") is the chief operating decision maker and has historically managed the Company as two reportable segments: Managed Services and Cloud and Business Intelligence ("CBI") based on the discrete financial information available for each segment. However, during the second half of 2015, we began implementing a series of actions to emphasizes a one-company, single go-to-market strategy for our services offering that resulted in the reorganization of our CBI personnel and sales team delivery structure. The objective of these actions was to more closely integrate and support the Managed Services organization with our cloud technologies and to eliminate new stand-alone CBI cloud offerings. Further, due to this reorganization and shift to a single go-to-market strategy, discrete cost information is no longer separately available for the former CBI segment. Consequently, beginning in the first quarter of 2016, our CEO manages and allocates resources on a company-wide basis as a single segment that is focused on service offerings which integrate data, processes and cloud technologies.

Key Business Metrics

In assessing the performance of our business, we consider a variety of business metrics in addition to the financial metrics discussed below under, “Basis of Presentation.” These key metrics include Opportunity Under Management and number of engagements, both of which are operational metrics.

Opportunity Under Management. At December 31, 2015, we estimated our Opportunity Under Management was approximately $9.9 billion. Opportunity Under Management is an operational metric that represents our estimate of the value of all end customer service contracts that we have the opportunity to sell on behalf of our clients over a designated period of time. In addition, we processed more than $4.0 billion of contract value through our cloud technologies in 2015 for which we received fees. Opportunity Under Management is not a measure of our expected revenue. Opportunity Under Management reflects our estimate over a designated period of time and should not be used to estimate our opportunity for any particular quarter within that period. Also, the value of end customer contracts actually delivered during a given period should not be expected to occur in even quarterly increments due to seasonality and other factors impacting our clients and their end customers. We estimate the value of such end customer contracts based on a combination of factors, including the value of end customer contracts made available to us by our clients in past periods, the minimum value of end customer contracts that our clients are required to give us the opportunity to sell pursuant to the terms of our contracts with them, periodic internal business reviews of our expectations as to the value of end customer contracts that will be made available to us by our clients, the value of end customer contracts included in the Service Performance Analysis ("SPA") and collaborative discussions with our clients assessing their expectations as to the value of service contracts that they make available to us for sale. While the minimum value of end customer contracts that our clients are required to give us represents a portion of our estimated Opportunity Under Management, a significant portion of the Opportunity Under Management is estimated based on the other factors described above. As our experience with our business, our clients and their contracts has grown, we have continually refined the process, improved the assumptions and expanded the data related to our calculation of Opportunity Under Management. When estimating Opportunity Under Management, we must, to a large degree, rely on the assumptions described above, which may prove incorrect. These assumptions are inherently subject to significant business and economic uncertainties and contingencies, many of which are beyond our control. Our estimates therefore may prove inaccurate, causing the actual value of end customer contracts delivered to us in a

given period to differ from our estimate of Opportunity Under Management. These factors include:

- the extent to which clients deliver a greater or lesser value of end customer contracts than may be required or otherwise expected;
- changes in the pricing or terms of service contracts offered by our clients;
- increases or decreases in the end customer base of our clients;
- the extent to which the renewal rates we achieve on behalf of a client early in an engagement affect the amount of

Table of Contents

opportunity that the client makes available to us later in the engagement;
•client cancellations of their contracts with us; and
•changes in our clients' businesses, sales organizations, management, sales processes or priorities.
Our revenue also depends on our booking rates and commissions. Our bookings is the total amount of Opportunity Under Management that we renew on behalf of our clients. Our commission rate is an agreed-upon percentage of the renewal value of end customer contracts that we sell on behalf of our clients.
Our booking rate is impacted principally by our ability to successfully sell service contracts on behalf of our clients. Other factors impacting our booking rate include: the manner in which our clients price their service contracts for sale to their end customers; the stage of life-cycle associated with the products and underlying technologies covered by the service contracts offered to the end customer; the extent to which our clients or their competitors introduce new products or underlying technologies; the nature, size and age of the service contracts; and the extent to which we have managed the renewals process for similar products and underlying technologies in the past.
In determining commission rates for an individual engagement, various factors, including our booking rate, as described above, are evaluated. These factors include: historical, industry specific and client specific renewal rates for similar service contracts; the magnitude of the Opportunity Under Management in a particular engagement; the number of end customers associated with these opportunities; and the opportunity to receive additional performance commissions when we exceed certain renewal levels. We endeavor to set our commission rates at levels commensurate with these factors and other factors that may be relevant to a particular engagement. Accordingly, our commission rates vary, often significantly, from engagement to engagement. In addition, we sometimes agree to lower commission rates for engagements with significant Opportunity Under Management.
In 2015, we experienced a decline in Opportunity Under Management due to a number of service contractions and non-renewals by some of our clients. We expect the reduction in Opportunity Under Management to be slightly up for the remainder of 2016 and increase in 2017.
Number of Engagements. We track the number of engagements we have with our clients. We often have multiple engagements with a single client, particularly where we manage the sales of service renewals relating to different product lines, technologies, types of contracts or geographies for the customer. When the set of renewals we manage on behalf of a client is associated with a separate client contract or a distinct product set, type of end customer contract or geography and therefore requires us to assign a service sales team to manage the renewals, we designate the set of renewals and associated revenues and costs as a unique engagement. For example, we may have one engagement consisting of a service sales team selling maintenance contract renewals of a particular product for a client in the United States and another engagement consisting of a sales team selling warranty contract renewals of a different product for the same client in Europe. These would count as two engagements. We had 154, 191 and 150 engagements as of December 31, 2015, 2014 and 2013, respectively.
Factors Affecting our Performance
Sales Cycle. We sell our integrated solution through our sales organization. At the beginning of the sales process, our quota-carrying sales representatives contact prospective clients and educate them about our offerings. Educating prospective clients about the benefits of our solution can take time, as many of these prospects have not historically relied upon integrated solutions like ours for service revenue management, nor have they typically put out a formal request for proposal or otherwise made a decision to focus on this area. As part of our sales process, we utilize our solutions design team to perform an SPA of our prospect's service revenue. The SPA includes an analysis of best-practices and benchmarks the prospect's service revenue against industry peers. Through the SPA process, which typically takes several weeks, we are able to assess the characteristics and size of the prospect's service revenue, identify potential areas of performance improvement, and formulate our proposal for managing the prospect's service revenue. The length of our sales cycle for a new client, inclusive of the SPA process and measured from our first formal discussion with the client until execution of a new client contract, is typically longer than six months and has increased in recent periods.
We generally contract with new clients to manage a specified portion of their service revenue opportunity, such as the opportunity associated with a particular product line or technology, contract type or geography. We negotiate the engagement specific terms of our client contracts, including commission rates, based on the output of the SPA,

including the areas identified for improvement. Once we demonstrate success to a client with respect to the opportunity under contract, we seek to expand the scope of our engagement to include other opportunities with the customer. For some customers, we manage all or substantially all of their service contract renewals.

Table of Contents

Implementation Cycle. After entering into an engagement with a new client, and to a lesser extent after adding an engagement with an existing client, we incur sales and marketing expenses related to the commissions owed to our sales personnel. These commissions are based on the estimated total contract value, with a material portion of the commission expensed upfront and the remaining portion expensed ratably over a period of twelve to fourteen months. We also make upfront investments in technology and personnel to support the engagement. These expenses are typically incurred one to three months before we begin generating sales and recognizing revenue. Accordingly, in a given quarter, an increase in new clients, and, to a lesser extent, an increase in engagements with existing clients, or a significant increase in the contract value associated with such new clients and engagements, will negatively impact our gross margin and operating margins until we begin to achieve anticipated sales levels associated with the new engagements, which is typically two to three quarters after we begin selling contracts on behalf of our clients. Although we expect new client engagements to contribute to our operating profitability over time, in the initial periods of a client relationship, the near term impact on our profitability can be negatively impacted by slower-than anticipated growth in revenues for these engagements as well as the impact of the upfront costs we incur, the lower initial level of associated service sales team productivity and lack of mature data and technology integration with the client. As a result, an increase in the mix of new clients as a percentage of total clients may initially have a negative impact on our operating results. Similarly, a decline in the ratio of new clients to total clients may positively impact our near-term operating results.

Contract Terms. A significant portion of our revenue comes from our pay-for-performance model. Under our pay-for-performance model, we earn commissions based on the value of service contracts we sell on behalf of our clients. In some cases, we earn additional performance-based commissions for exceeding pre-determined service renewal targets.

Our new client contracts typically have an initial term between two and four years. Our contracts generally require our clients to deliver a minimum value of qualifying service revenue contracts for us to renew on their behalf during a specified period. To the extent that our customers do not meet their minimum contractual commitments over a specified period, they may be subject to fees for the shortfall. Our client contracts are cancelable on relatively short notice, subject in most cases to the payment of an early termination fee by the client. The amount of this fee is based on the length of the remaining term and value of the contract.

We invoice our clients on a monthly basis based on commissions we earn during the prior month, and with respect to performance-based commissions, on a quarterly basis based on our overall performance during the prior quarter. Revenue is recognized in the period in which our services are performed or, in the case of performance commissions, when the performance condition is achieved. Because the invoicing for our services generally coincides with or immediately follows the sale of service contracts on behalf of our clients, we do not generate or report a significant deferred revenue balance. However, the combination of factors such as, but not limited to, minimum contractual commitments, the performance improvement potential identified by our SPA process, our success in generating improved renewal rates for our customers, and our customers' historical renewal rates, for example, help to provide us with revenue visibility, but may all affect our performance favorably or unfavorably.

M&A Activity. Our clients, particularly those in the technology sector, participate in an active environment for mergers and acquisitions. Large technology companies have maintained active acquisition programs to increase the breadth and depth of their product and service offerings and small and mid-sized companies have combined to better compete with large technology companies. A number of our clients have merged, purchased other companies or been acquired by other companies. We expect merger and acquisition activity to continue to occur in the future.

The impact of these transactions on our business can vary. Acquisitions of other companies by our customers can provide us with the opportunity to pursue additional business to the extent the acquired company is not already one of our customers. Similarly, when a client is acquired, we may be able to use our relationship with the acquired company to build a relationship with the acquirer. In some cases we have been able to maintain our relationship with an acquired customer even where the acquiring company handles its other service contract renewals through internal resources. In other cases, however, acquirers have elected to terminate or not renew our contract with the acquired company.

Economic Conditions and Seasonality. An improving economic outlook generally has a positive, but mixed, impact on our business. As with most businesses, improved economic conditions can lead to increased end customer demand and sales. In particular, within the technology sector, we believe that economic downturns lead many companies to cut their expenses by choosing to let their existing maintenance, support and subscription agreements lapse. An improving economy may have the opposite effect.

However, an improving economy may also cause companies to purchase new hardware, software and other technology products, which we generally do not sell on behalf of our clients, instead of purchasing maintenance, support and subscription services for existing products. To the extent this occurs, it would have a negative impact on our opportunities in the near term that would partially offset the benefits of an improving economy.

Table of Contents

We believe the current uncertainty in the economy, combined with shifting market forces toward subscription-based models, is impacting a number of our clients and prospective clients, particularly in the traditional enterprise software and hardware segments. These forces have placed pressure on end customer demand for their renewal contracts and also have led to some slower decision making in general. This economic and industry environment has adversely affected the conversion rates for end customers and contracts. To the extent these conditions continue they will impact our future revenues.

In addition to the uncertainty in the macroeconomic environment, we experience a seasonal variance in our revenue typically for the third quarter of the year as a result of lower or flat renewal volume corresponding to the timing of our customers' product sales particularly in the international regions. The impact of this seasonal fluctuation can be amplified if the economy as a whole is experiencing disruption or uncertainty, leading to deferral of some renewal decisions. As we increase our subscription revenue base, this seasonality will become less apparent. However, for at least the foreseeable future, we would expect this pattern to continue.

Within the software industry, there is a growing trend toward providing software to clients using a SaaS model. Under this model, SaaS companies provide access to software applications to customers on a remote basis, and provide their customers with a subscription to use the software, rather than licensing software to their customers.

We have several SaaS-based applications that we develop and support: Renew OnDemand (our purpose-built offering to manage and maximize recurring revenue), ServiceSource Revenue Analytics (our SaaS offering to help companies with predictive analytics for recurring revenue), and other SaaS cloud technologies such as ServiceSource Customer Success. Our research and development costs are primarily related to these SaaS based applications and development of other technologies that are integrated with our overall solutions. We intend to maintain client support, training and professional service organizations to support deployments of our SaaS based applications and solutions.

Basis of Presentation

Net Revenue

Substantially all of our net revenue is attributable to commissions we earn from the sale of renewals of maintenance, support and subscription agreements on behalf of our clients. We generally invoice our clients for our services in arrears on a monthly basis for sales commissions, and on a quarterly basis for certain performance sales commissions; accordingly, we typically have no deferred revenue related to these services. We do not set the price, terms or scope of services in the service contracts with end customers and do not have any obligations related to the underlying service contracts between our clients and their end customers.

We also earn revenue from the sale of subscriptions to our cloud based applications. To date, subscription revenue has been a small percentage of total revenue. We expect revenues generated from subscriptions of Renew OnDemand and ServiceSource SaaS cloud technologies to be flat for the remainder of 2016. Subscription fees are accounted for separately from commissions, and they are billed in advance over a monthly, quarterly or annual basis. Subscription revenue is recognized ratably over the related subscription term.

We have generated a significant portion of our revenue from a limited number of clients. Our top ten customers accounted for 65% and 56% of our net revenue for the nine months ended September 30, 2016 and 2015, respectively. The loss of revenue from any of our top clients for any reason, including the failure to renew our contracts, termination of some or all of our services, a change of relationship with any of our key clients or their acquisition, can cause a significant decrease in our revenue.

Our business is geographically diversified. Through the first nine months of 2016, 65% of our net revenue was earned in North America and Latin America ("NALA"), 24% in Europe, Middle East and Africa ("EMEA") and 11% in Asia Pacific-Japan ("APJ"). Net revenue for a particular geography generally reflects commissions earned from sales of service contracts managed from our sales centers in that geography. Predominantly all of the service contracts sold and managed by our sales centers relate to end customers located in the same geography. APJ is our newest region, and as a result accounts for less of our net revenue. In addition, our Kuala Lumpur, Manila and Sofia locations are global service delivery centers where we have centralized, for our worldwide operations, the key contract renewal processes that do not require regional expertise, such as client data management and quoting.

Table of Contents

Cost of Revenue and Gross Profit

Our cost of revenue expenses include employee compensation, technology costs, including those related to the delivery of our cloud-based technologies, and allocated overhead costs. Compensation expense includes salary, bonus, benefits and stock-based compensation for our dedicated service sales teams. Our allocated overhead includes costs for facilities, information technology and depreciation, including amortization of internal-use software associated with our service revenue technology platform and cloud applications. Allocated costs for facilities consist of rent, maintenance and compensation of personnel in our facilities departments. Our allocated costs for information technology include costs associated with third-party data centers where we maintain our data servers, compensation of our information technology personnel and the cost of support and maintenance contracts associated with computer hardware and software. To the extent our customer base or Opportunity Under Management expands, we may need to hire additional service sales personnel and invest in infrastructure to support such growth. Our cost of revenue may fluctuate significantly and increase or decrease on an absolute basis and as a percentage of revenue in the near term, including for the reasons discussed under, “Factors Affecting Our Performance-Implementation Cycle”. We saw material reductions in cost of revenue expenses in 2015 related primarily to our efforts to better align our personnel costs with the decrease in revenue during 2015. We expect cost of revenues to increase slightly through the remainder of 2016 as additional cost reduction measures will be offset by incremental investments in technology, the addition of new service delivery centers and increased costs related to expansion of our services. Gross profit as a percent of revenue is expected to improve over prior year periods as we anticipate revenue growing faster than our cost of revenue.

Operating Expenses

Sales and Marketing. Sales and marketing expenses are a significant component of our operating costs and consist primarily of compensation expenses and sales commissions for our sales and marketing staff, allocated expenses and marketing programs and events. We sell our solutions through our global sales organization, which is organized across three geographic regions: NALA, EMEA and APJ. Our commission plans provide that payment of commissions to our sales representatives is contingent on their continued employment, and we recognize expense over a period that is generally between the contract signing date and twelve to fourteen months following the execution of the applicable contract. When commissions are paid upon contract signing and are not contingent on future payments and continued employment, we consider that portion of the commission to be earned and therefore expensed at contract signing. We currently expect sales and marketing expenses to be up in the remainder of 2016 due to normal higher seasonal spend in our fourth quarter.

Research and Development. Research and development expenses consist primarily of employee compensation expense, allocated costs and the cost of third-party service providers. We focus our research and development efforts on developing new products and applications related to our technology platform. In connection with the development and enhancements of our SaaS cloud applications, we capitalize certain expenditures related to the development and enhancement of internal-use software related to our technology platform. We expect research and development spending to remain flat or increase slightly for the remainder of 2016, and decrease or remain flat as a percentage of revenue in future years.

General and Administrative. General and administrative expenses consist primarily of employee compensation expense for our executive, human resources, finance and legal functions, and related expenses for professional fees for accounting, tax and legal services, as well as allocated expenses. We expect that our general and administrative expenses will increase for the remainder of 2016 as we invest in facilities, expand our learning and development function and invest in additional information technology.

Restructuring and other. Restructuring and other expenses consist primarily of stock compensation expense related to the accelerated vesting of certain equity awards, employees' separation payments and related employee benefits and charges related to cancellation of contracts. We completed this restructuring in 2015.

Interest Expense and Other, Net and Impairment of Cost Basis Equity Investment

Interest expense. Interest expense consists of interest expense associated with our convertible debt, imputed interest from capital lease payments, accretion of debt discount; and amortization of debt issuance costs. We recognize accretion of debt discount and amortization of interest costs using the effective interest method. We expect our interest

expense to increase slightly for the remainder of 2016 from accretion of debt discount, amortization of deferred financing costs and contractual interest costs as a result of our August 2013 issuance of $150.0 million aggregate principal amount of convertible notes due August 2018.

Other, net. Other, net consists primarily of foreign exchange gains and losses and the interest income earned on our cash, cash equivalents and marketable securities investments. We expect other income to vary depending on the movement in foreign currency exchange rates and the related impact on our foreign exchange gain (loss) and the return of interest on our investments.

Table of Contents

Impairment of cost basis equity investment. We recorded an impairment charge related to a cost basis equity investment during the three months ended September 30, 2016. Changes in business conditions and other economic factors related to our cost basis equity investment may require us to record additional impairment charges in the future.

Income Tax Provision (Benefit)

We account for income taxes using an asset and liability method, which requires the recognition of taxes payable or refundable for the current year and deferred tax assets and liabilities for the expected future tax consequences of temporary differences that currently exist between the tax basis and the financial reporting basis of our taxable subsidiaries' assets and liabilities using the enacted tax rates in effect for the year in which the differences are expected to reverse. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in operations in the period that includes the enactment date. The measurement of deferred tax assets is reduced, if necessary, by the amount of any tax benefits that, based on available evidence, are not expected to be realized.

We evaluate our ability to realize the tax benefits associated with deferred tax assets on a jurisdictional basis. This evaluation utilizes the framework contained in ASC 740, Income Taxes, wherein management analyzes all positive and negative evidence available at the balance sheet date to determine whether all or some portion of our deferred tax assets will not be realized. Under this guidance, a valuation allowance must be established for deferred tax assets when it is more likely than not (a probability level of more than 50 percent) that they will not be realized. In assessing the realization of our deferred tax assets, we consider all available evidence, both positive and negative, and place significant emphasis on guidance contained in ASC 740, which states that "a cumulative loss in recent years is a significant piece of negative evidence that is difficult to overcome."

We account for unrecognized tax benefits using a more-likely-than-not threshold for financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. We establish reserves for tax-related uncertainties based on estimates of whether, and the extent to which, additional taxes will be due. We record an income tax liability, if any, for the difference between the benefit recognized and measured and the tax position taken or expected to be taken on our tax returns. To the extent that the assessment of such tax positions change, the change in estimate is recorded in the period in which the determination is made. The reserves are adjusted in light of changing facts and circumstances, such as the outcome of a tax audit. The provision for income taxes includes the impact of reserve provisions and changes to reserves that are considered appropriate.

Table of Contents

Results of Operations

The table below sets forth our consolidated results of operations for the periods presented. As described in Note 1 of the Notes to the Condensed Consolidated Financial Statements, the results of operations for the periods presented below have been restated to reflect prior period error correction to income tax expense. The period-to-period comparison of financial results presented below is not necessarily indicative of financial results to be achieved in future periods.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(in thousands)			
Net revenue	$62,514	$59,432	$184,233	$187,242
Cost of revenue	40,789	42,568	122,568	131,076
Gross profit	21,725	16,864	61,665	56,166
Operating expenses:				
Sales and marketing	8,847	10,667	30,626	31,667
Research and development	1,952	3,474	6,132	12,942
General and administrative	14,638	10,912	38,233	33,778
Restructuring and other	—	(2)	—	3,737
Total operating expenses	25,437	25,051	74,991	82,124
Loss from operations	(3,712)	(8,187)	(13,326)	(25,958)
Interest expense and other, net	(2,291)	(2,513)	(5,499)	(7,097)
Impairment of cost basis equity investment	(2,300)	—	(2,300)	—
Loss before income taxes	(8,303)	(10,700)	(21,125)	(33,055)
Income tax provision	968	203	2,505	1,515
Net loss	$(9,271)	$(10,903)	$(23,630)	$(34,570)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(in thousands)			
Includes stock-based compensation of:				
Cost of revenue	$299	$704	$1,146	$2,200
Sales and marketing	565	796	2,152	2,443
Research and development	106	322	448	1,314
General and administrative	1,276	1,438	3,695	4,847
Total stock-based compensation	$2,246	$3,260	$7,441	$10,804

Table of Contents

The following table sets forth our operating results as a percentage of net revenue:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(as % of net revenue)			
Net revenue	100 %	100 %	100 %	100 %
Cost of revenue	65 %	72 %	67 %	70 %
Gross profit	35 %	28 %	33 %	30 %
Operating expenses:				
Sales and marketing	14 %	18 %	17 %	17 %
Research and development	3 %	6 %	3 %	7 %
General and administrative	23 %	18 %	21 %	18 %
Restructuring and other	— %	— %	— %	2 %
Total operating expenses	40 %	42 %	41 %	44 %
Loss from operations	(5)%	(14)%	(8)%	(14)%

Three and nine months ended September 30, 2016 and September 30, 2015

Net Revenue, Cost of Revenue and Gross Profit

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2016	2015	Change	% Change	2016	2015	Change	% Change
	(in thousands)				(in thousands)			
Net Revenue	$62,514	$59,432	$3,082	5 %	$184,233	$187,242	$(3,009)	(2)%
Cost of Revenue	40,789	42,568	(1,779)	(4)%	122,568	131,076	(8,508)	(6)%
Gross Profit	$21,725	$16,864	$4,861	29 %	$61,665	$56,166	$5,499	10 %

Net revenue increased $3.1 million, or 5%, for the third quarter of 2016 compared to the third quarter of 2015. The overall increase in revenue was due to expansion of business with the existing client base, as well as new business with existing clients and with new clients in the third quarter of 2016.

The $1.8 million, or 4%, decrease in our cost of revenue in the third quarter of 2016 compared to the third quarter of 2015 reflects a $2.0 million decrease in employee related costs as a result of shifting headcount to lower cost offices and locations, all related to our continuous efforts to better align employee costs with revenue, a decrease of $1.5 million in temporary labor and consulting costs, offset by a $0.4 million increase in information technology costs and $0.1 million increase in travel costs.

Gross profit in the third quarter of 2016 increase by $4.9 million, or 29%, compared to the same period in 2015 which is in line with the increase in revenue and proportionate reduction in employee related costs.

Net revenue decreased $3.0 million, or 2%, for the nine months ended September 30, 2016 compared to the nine months ended September 30, 2015. The overall decrease in revenue was due to service cancellations and reductions with the existing client base in the first quarter of 2016 as compared to the first quarter of 2015 which impacted the nine months ended September 30, 2016.

The $8.5 million, or 6%, decrease in our cost of revenue in the nine months ended September 30, 2016 compared to the nine months ended September 30, 2015 reflects a $9.2 million decrease in employee related costs as a result of shifting headcount to lower cost offices and locations, which is related to our continuous efforts to better align

employee costs with revenue. Also contributing to the decrease was a $3.4 million reduction in temporary labor and consulting costs. Offsetting these decreases was a $2.6 million increase in overhead allocations, $0.6 million increase in information technology costs, $0.2 million increase in travel costs and $1.1 million increase in depreciation and amortization expense.

Gross profit in the nine months ended September 30, 2016 increased by $5.5 million, or 10%, compared to the same period in 2015 which is in line with the decrease in revenue and employee related costs.

Table of Contents

Operating Expenses

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2016	2015	Change	% Change	2016	2015	Change	% Change
	(in thousands)				(in thousands)			
Operating expenses:								
Sales and marketing	$8,847	$10,667	$(1,820)	(17)%	$30,626	$31,667	$(1,041)	(3)%
Research and development	1,952	3,474	(1,522)	(44)%	6,132	12,942	(6,810)	(53)%
General and administrative	14,638	10,912	3,726	34%	38,233	33,778	4,455	13%
Restructuring and other	—	(2)	2	(100)%	—	3,737	(3,737)	(100)%
Total operating expenses	$25,437	$25,051	$386	2%	$74,991	$82,124	$(7,133)	(9)%
Includes stock-based compensation of:								
Sales and marketing	$565	$796	$(231)		$2,152	$2,443	$(291)	
Research and development	106	322	(216)		448	1,314	(866)	
General and administrative	1,276	1,438	(162)		3,695	4,847	(1,152)	
Total stock-based compensation	$1,947	$2,556	$(609)		$			