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

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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.

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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.

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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.

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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.

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SERVICESOURCE INTERNATIONAL, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Note 1 — Description of Business and Basis of Presentation

ServiceSource International, Inc. (together with its subsidiaries, the “Company”) is a global leader in 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.

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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.

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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.

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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)

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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):

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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.

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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

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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

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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.

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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.

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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.

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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.

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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