

SERVICESOURCE INTERNATIONAL, INC.

Form 10-K

March 07, 2014

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

FORM 10-K

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

For the fiscal year ended December 31, 2013

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 its charter)

Delaware

(State or Other Jurisdiction of  
Incorporation or Organization)

No. 81-0578975

(I.R.S. Employer  
Identification No.)

634 Second Street  
San Francisco, California

(Address of Principal Executive Offices)

94,107

(Zip Code)

Registrant's telephone number, including area code: (415) 901-6030

Securities registered pursuant to Section 12(b)

Common Stock, \$0.0001 Par Value

Securities registered pursuant to Section 12(g) of the Act:

None

Name of each exchange on which registered  
The NASDAQ Stock Market LLC

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§29.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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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 definition of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer

Non-accelerated filer  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

The aggregate market value of the voting and non-voting common stock held by non-affiliates of the registrant, computed by reference to the closing price at which the common stock was sold on June 28, 2013, the last business day of the registrant’s most recently completed second fiscal quarter, as reported on The NASDAQ Global Market, was \$360,520,829. Shares of common stock held by each executive officer, director and holder of 5% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status does not reflect a determination that such persons are affiliates of the registrant for any other purpose.

As of February 28, 2014, there were approximately 82,583,868 shares of the registrant’s common stock outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant’s definitive Proxy Statement for its 2014 Annual Meeting of Stockholders are incorporated by reference in Part III of this Annual Report on Form 10-K. Such Proxy Statement will be filed with the U.S. Securities and Exchange Commission within 120 days after the end of the fiscal year to which this report relates. Except with respect to information specifically incorporated by reference in this Form 10-K, the Proxy Statement is not deemed to be filed as part of this Form 10-K.

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**SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS AND INDUSTRY DATA**

This Annual Report on Form 10-K contains certain statements that constitute “forward looking statements” within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward looking statements are based on our management’s beliefs and assumptions and on information currently available to our management. The forward looking statements are contained principally in “Business,” “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” Forward looking statements include information concerning our possible or assumed future results of operations; estimates of recurring revenue opportunity under management; changes in market conditions that impact our ability to generate recurring revenue on our customers’ behalf; errors in estimates as to the recurring revenue we can generate for our customers; risks associated with material defects or errors in our software or the effect of data security breaches; our ability to adapt our solution to changes in the market or new competition; our ability to improve our customers’ renewal rates, margins and profitability; our ability to increase our revenue and contribution margin over time from new and existing customers, including as a result of sales of Renew OnDemand, on a stand-alone subscription basis; our ability to implement Renew OnDemand; the potential effect of mergers and acquisitions on our customer base; business strategies and new sales initiatives; technology development; protection of our intellectual property; investment and financing plans; liquidity; competitive position; the effects of competition; industry environment; our ability to acquire and integrate business and technologies; litigation involving us; and potential growth opportunities. Forward looking statements include all statements that are not historical facts and can be identified by terms such as “anticipates,” “believes,” “could,” “estimates,” “expects,” “intends,” “likely,” “may,” “might,” “plans,” “potential,” “predicts,” “should,” “will,” “would” or similar expressions and the negatives of those terms.

Forward looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward looking statements. We discuss these risks in greater detail in “Risk Factors” and elsewhere in this Annual Report on Form 10-K. Given these uncertainties, you should not place undue reliance on these forward looking statements. Also, forward looking statements represent our management’s beliefs and assumptions only as of the date of this Annual Report on Form 10-K. You should read this Annual Report on Form 10-K and the documents that we have filed as exhibits hereto, completely and with the understanding that our actual future results may be materially different from what we expect.

Except as required by law, we assume no obligation to update these forward looking statements publicly, or to update the reasons actual results could differ materially from those anticipated in these forward looking statements, even if new information becomes available in the future.

In addition, projections, assumptions and estimates of our future performance and the future performance of the industry in which we operate is necessarily subject to a high degree of uncertainty and risk due to a variety of factors, including those described in “Risk Factors” and elsewhere in this Annual Report on Form 10-K. These and other factors could cause results to differ materially from those expressed in the estimates made by the independent parties and by us.

As used herein, “ServiceSource” the “Company,” “we,” “our,” and similar terms include ServiceSource International, Inc. and its subsidiaries, unless the context indicates otherwise.

**PART I**

**ITEM 1.**

**BUSINESS**

**Overview**

ServiceSource International, Inc. (NASDAQ: SREV) is a global leader in recurring revenue management partnering with technology and technology-enabled companies to optimize maintenance, support and subscription revenue streams, while also improving customer relationships and loyalty. We deliver these results via a cloud application , Renew OnDemand and associated managed services, leveraging benchmarks and best practices derived from our rich database of service and renewal behavior. By integrating software, managed services and data, we provide end-to-end management and optimization of the service-contract renewals process, including data management, quoting, selling

and recurring-revenue business intelligence. Our managed services business is built on our pay-for-performance model, whereby customers pay us a commission based on renewal sales that we generate on their behalf, enabling a success-driven, shared-risk partnership with our customers.

ServiceSource offers a cloud application, Renew OnDemand, to automate this highly valuable but typically manual business process. Renew OnDemand and our proven managed services, drive higher subscription, maintenance and support revenue while improving customer retention and increasing business predictability.

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ServiceSource delivers results by leveraging best practices derived from our extensive database of service and renewal behavior across companies, industries and geographies. By integrating cloud services, managed services and renewal-ready data, we provide end-to-end management and optimization of the recurring revenue process, including data management, quoting, selling and business intelligence.

Our managed services business is built on our pay-for-performance model, whereby customers pay us a commission based on renewal sales that we generate on their behalf, enabling a success-driven, shared-risk partnership with our customers.

Renew OnDemand, our cloud application built to maximize recurring revenue, can be purchased with or without our managed selling services.

As of December 31, 2013, we managed approximately 150 engagements across more than 70 customers, representing over \$11.6 billion recurring revenue opportunity under management. Recurring revenue opportunity under management is a forward-looking metric and is our estimate, as of a given date, of the value of all end customer service contracts that we will have the opportunity to sell on behalf of our customers over the subsequent twelve-month period.

The scalability of our solution enables us to sell in over 40 languages from six sales 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, technology-enabled health care and life sciences.

Our total revenue was \$272.5 million, \$243.7 million and \$205.5 million for the years ended December 31, 2013, 2012 and 2011, respectively. For summarized financial information by geographic area, see Note 14 of the Notes to Consolidated Financial Statements. For a discussion of the development of our business over the last year, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Overview.”

We were incorporated in Delaware as a limited liability company in 2002 and converted to a Delaware corporation on March 24, 2011. Additional information about us is available on our website at <http://www.servicesource.com>. The information on our website is not incorporated herein by reference and is not a part of this Form 10-K. We make available free of charge on our corporate website our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as soon as reasonably practicable after those reports are electronically filed with, or furnished to, the SEC. From time to time, we may use our website as a channel of distribution of material Company information. Financial and other material information regarding our business is routinely posted on and accessible at <http://ir.servicesource.com>.

Our Solution

Our solution is based on a decade of experience pioneering the recurring revenue management category and is designed to optimize recurring revenue performance for our customers. It addresses the critical elements of the renewals process, including data management, quoting, selling and recurring-revenue business intelligence. We believe our solution, reflects the growing trend of delivering enterprise services via the cloud. We believe this approach is critical to addressing the unique requirements of effective recurring revenue management.

The components of our solution consist of our Renew OnDemand SaaS application introduced in September 2012, Scout Analytics (that was acquired in January 2014) and a suite of managed services. The foundation of our solution is Renew OnDemand, a SaaS-based renewal management system based on our data warehouse of transactional, analytical and industry data that grows with each service renewal transaction and customer. Our suite of cloud applications increase visibility and control of recurring revenue streams and are utilized by customers, their channel partners, end customers and our service sales teams. Our managed services including data, enablement and selling services, in which dedicated service teams have specific expertise in our customers’ businesses, are deployed under our customers’ brands and follow a sales process tailored specifically to increase service contract renewals.

## Renew OnDemand Platform

Since our inception, we have developed and evolved our data capabilities which provide customers with a unified view of their data from diverse sources and leverage a data warehouse of transactional, analytical and industry information to offer a comparative view of our customers' results against their industry peers. This information includes:

Transactional data. An integral part of our renewals process is the broad data capture we perform to ensure we have documented the important information about each transaction. With over four million transactions completed since inception, we have been able to build a robust data warehouse of recurring revenue and renewals information.

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**Analytical data .** We track and leverage dozens of KPIs and benchmarks in our platform across our business. The data has been analyzed across a number of dimensions, such as region, customer segment, and contract dollar value, among others.

**Industry data .** At the core of our platform is a recurring revenue-specific data model and benchmarking database that allows us to extract transactional data from customers and capture other structured and unstructured analytical data in a consistent manner. This allows us to benchmark performance across industries and perform cohort analyses to understand where we can apply best practices to increase performance.

Our platform improves with every renewal we manage, every customer we engage, and every benchmarking study we complete. We believe this is the most comprehensive data warehouse built exclusively for managing and optimizing recurring revenue from maintenance, support and subscription agreements on behalf of third-party customers.

Renew OnDemand includes key applications that help customers increase recurring revenue and profitability, improve retention and gain unique business insights. These applications are designed to optimize specific elements of the renewals process. Our applications reflect our experience in optimizing recurring revenue and are tested for usability and impact inside our own operations. Our suite of applications includes:

**Renew Analytics.** Our Analytics application provides analysis and reporting. It delivers dashboards to view and analyze recurring revenue performance by customer, revenue tier, channel partner, product line and region. It also provides real-time visibility into expected results, conversion and up-sells, territory analysis, benchmarking and other trending reports. This tool enables the executive staff of our customers to identify trends and update sales strategies.

**Renew Sales.** This application module provides the information, best practices and automation needed by a renewal sales team in a simple, easy-to-use application built specifically for maximizing recurring revenue streams. Renew Sales automates time-consuming manual activities while providing all the essential information needed to identify opportunities and close a sale. It includes quoting, forecasting, and workflow tools as well as an analytics dashboard which allows sales people and managers the ability to view overall pipeline, top opportunities and performance trendsprofessionals.

**Renew Ops.** Renew Ops allows customers to separate selling and administrative activities so their sales people can focus on selling. Sales administration teams have a complete application to manage all operational activities and ensure tasks are completed in an accurate and timely fashion.

**Renew Channel.** Our Channel application provides channel partners and resellers with online access to their specific renewals opportunities and their performance. The application includes an executive dashboard that enables partners to view their renewals pipeline, their performance against key performance targets and how they are trending compared to previous quarters. In addition, an opportunity view allows partners to manage each upcoming renewal opportunity, find account, contact and asset information specific to that opportunity, download pre-built quotes and request assistance from us to support the sales process.

**Renew Installed Base.** Our Installed Base application provides a single repository for cleansed installed-base data and deep business intelligence to analyze the integrity and completeness of the data to flag anomalies and missing data elements and to identify cross- sell and up-sell opportunities. The application provides resellers, distributors and sales representatives with an accurate view of the installed base, including information on end customer purchases and usage. Renew Installed Base also facilitates workflow between sales representatives, channel partners and the ServiceSource sales operations teams to correct installed base data issues in the customer's source data systems.

### Scout Analytics

The Scout Suite is an array of role-based products that leverage the Scout Platform, a powerful recurring revenue management solution designed to maximize customer value and accelerate growth in revenue and profits. All of the products in the Scout Suite help companies integrate customer data, predict opportunities, and automate customer



engagement processes-but each product comes with its own specialized workflows, automation, and reports, designed to solve specific recurring revenue challenges.

#### Managed Services

We leverage our knowledge base across critical business processes, including:

Service Performance Analysis . During the SPA process, we conduct interviews of our prospective customers,

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analyze their historical performance and future opportunity, and evaluate their recurring revenue business on a number of dimensions. We also use our breadth of experience to benchmark and identify service renewal opportunities, and to calculate our ability to improve performance based on our performance with similar types of businesses and opportunities.

**Business Case, Pricing and Contract Structuring** . We utilize our reservoir of data and benchmarks to estimate the critical components of the business case and pricing model that we use in discussions with prospective customers.

This intelligence is fundamental to our pay-for-performance business model.

**Recurring revenue Performance** . Once a partnership is in place with our customer, we leverage our data warehouse to enable, measure, analyze, benchmark, optimize and continuously improve the performance of our service sales teams.

**Customer Benchmarking and Continuous Improvement** . Our extensive renewals platform serves as the foundation to benchmark our customers' evolving recurring revenue performance against industry peers and previous period performance. We convene quarterly business review meetings and annual partnership reviews with our customers to review performance, identify potential weaknesses in the renewals process and opportunities for improvement, and make recommendations that we believe will allow our customers and us to achieve higher levels of performance and efficiencies.

**Developing and Delivering Applications** . Our data warehouse that fuels the opportunity data, sales methodologies, metrics, and reporting dashboards that we engineer into our applications. Accordingly, we design our applications to leverage the transactional, analytical and industry data housed in our platform.

We employ service sales personnel that interact directly with end customers to sell service renewals. They also provide active sales enablement, support and management of channel partners. Our service sales teams act as an extension of our customers' brands.

We have developed a set of best practices that includes role specialization for selling, enablement, and data service. We believe that role specialization is a key component in driving higher recurring revenue rates. We offer a package of managed services for each of these specialized roles, and our customers can chose to purchase individual solutions or as a full pay for performance solution. They include Selling Services, Enablement Services, and Data Services. Our service sales teams are grouped into three primary areas:

**Selling Services** We offer customers the ability to buy a high performance sales team to drive recurring revenue as part of a full pay for performance solution. Our team acts as an extension of the customer's sales team, directly contacting end users and channel partners to drive recurring revenue, close contracts, and upsell/cross-sell additional products and services. Our sales teams are trained in our renewals sales methodology, a set of proven best practices developed over twelve years of experience focused exclusively on recurring revenue sales. They undergo extensive training on our processes, applications, and on products, competitive differentiation and value propositions of the products and services they represent. This team is backed up by our sales enablement and data services teams which are provided as separate and complementary offerings.

**Enablement Services** We provide recurring revenue forecasting tailored to fit our customers' bookings, revenue targets and specific reporting requirements. We supply a dedicated team of resources and tools to build and update customer and channel partner quotes and distribute them to the sales teams, channel partners and customers. Finally, we offer a business analytics team that provides analysis to maximize recurring revenue performance and provide insight into end customers, competitors and channel partners.

**Data Services** Our specially trained data teams pull together and prepare critical renewals data from disparate sources, creating a holistic view of the recurring revenue opportunity. A single renewal often requires up to 100 data elements - 10 times more than that of a new product sale, typically from five to seven disparate systems. Our data teams merge and cleanse data, and continuously analyze data quality to track improvement over time.

Our Renew OnDemand platform, as well as our legacy cloud based solution, are hosted at third-party data centers where we employ rigorous technologies, policies and procedures to protect customer data.

Key benefits of our solution include:

Financial Benefits

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Increased recurring revenue. Our solution is designed to increase recurring revenues for our customers. Each customer engagement begins with a Service Performance Assessment (“SPA”), an in-depth analysis of customers’ current renewal rates. We actively monitor the contract renewal rates we drive on behalf of our customers in each engagement. When we generate higher renewal rates, we not only drive incremental revenue for the associated period, but also have a compounding effect in increasing the base number of contracts eligible for renewal in subsequent periods, which expands the opportunity to generate greater revenue in future periods.

Increased margin and profitability. We believe that the costs associated with delivering maintenance, support and subscription services by many of our customers can be relatively fixed, and thus growth of these recurring revenue streams can benefit our customers’ profitability. In addition, customers that deploy our solution can avoid infrastructure expenditures and personnel costs that would otherwise be associated with managing renewals internally. As a result, each incremental dollar of recurring revenue generated by our solution can drive greater profitability for our customers.

### Operational Benefits

Greater business insight and analytics. Our Renew OnDemand™ Platform allows us to analyze our customers’ renewals against similar transactions and to identify areas for improvement, enabling greater insight into their renewals business. All transactions, whether or not resulting in a successful renewal by an end customer, are recorded in our platform. We leverage this platform to provide benchmarking, end customer metrics, sales efficiency data and insight into successful and unsuccessful renewal efforts. The breadth of our data allows us to provide powerful analysis across regions, industries, channel partners and product segments.

Greater visibility and forecasting tools. Our cloud applications deliver real-time analytics and visibility into a customer’s recurring revenue performance, sales efficiency and forecasts. We measure recurring revenue performance across dozens of Key Performance Indicators (“KPIs”) and provide real-time data to our customers through a clear and impactful web-based interface. CFOs and other executives rely on our applications to assist in forecasting their results and to measure progress against their forecasts on a real-time basis.

Strengthened channel loyalty. Our Channel Sales Cloud application empowers our customers’ channel partners to generate higher sales by providing accurate, real-time data on their renewal opportunities and performance relative to quota, as well as tools to sell more effectively to end customers. Our cloud applications help our customers develop a closer relationship with their channel partners and enable our customers to increase renewals through the channel.

Global consistency. We are able to maintain a globally consistent renewals process for our customers. Our global sales centers operate from a unified platform. Our solution automates the application of best practices to the recurring revenue renewals process and provides all relevant constituencies with a consistent view of the data. This facilitates contract renewals and provides reliable performance management and analytics.

### Our Strategy

We intend to continue our industry leadership in recurring revenue management with the following strategies:

Increased use and adoption of our industry-leading cloud application. Offered on a subscription basis, Renew OnDemand is the core foundation of our customer-facing cloud applications in addition to being used for our internal operations. Our Renew OnDemand subscription offering is differentiated by our ability to provide a suite of managed services to create renewal ready data to enable high performance sales. As we move from one complete solution to an unbundled offering, we offer a menu of services which customers can attach to their Renew OnDemand subscriptions. These services include data services, enablement services, selling services and support services.

Expand our customer base to additional industry verticals. We recognize that recurring revenue opportunities exist in sectors beyond the technology industry we have traditionally served. Our penetration in the SaaS market has grown

significantly this year. We currently have a small number of technology-enabled health care and life sciences and industrial systems customers for whom we manage equipment maintenance and support contracts. We believe there are additional industry verticals that can benefit from our expertise and best practices, and we intend to pursue these opportunities.

• Expand our customer base within existing industry verticals. We believe there is a significant opportunity to increase our recurring revenue opportunity under management. We currently have more than 70 customers and believe there

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are over 800 companies in our addressable market. In addition, we intend to increase investment in our sales and marketing organization to win new customers in technology and technology-enabled industries.

Increase footprint with existing customers to drive greater revenue per customer. Our goal is to manage a greater portion of each customer's recurring revenue. Typically, we initially manage one component of a customer's recurring revenue, such as a specific product, market segment or geographic region. Because we baseline our customers' performance prior to any engagement, we are able to quantify our results for the customer, frequently leading to an increase of revenue opportunity under management for that customer, and ultimately greater revenue.

Develop new functionality for Renew OnDemand. We have developed Renew OnDemand to drive increases in efficiency and help to automate tasks associated with recurring revenue management. By continuing to automate processes and innovate on our technology platform, we can lower operating costs, increase the efficiency of our solutions and ultimately enhance our profitability and cash flow.

### Customers

We sell our solutions to technology and technology-enabled health care and life sciences companies. As of December 31, 2013, we managed approximately 150 engagements across more than 70 customers, representing over \$11.6 billion in recurring revenue opportunity under management.

Our top ten customers accounted for approximately 50%, 50% and 47% of our revenue in 2013, 2012 and 2011, respectively. One customer represented over 10% of our revenue in 2013, 2012 and 2011.

### Sales and Marketing

We sell our solutions through our global sales organization. Our sales representatives are organized by geographic regions: North America and Latin America ("NALA"), Europe, Middle East and Africa ("EMEA") and Asia Pacific-Japan ("APJ"); and by industry verticals. We deploy quota-carrying sales and solution design professionals to target specific regions and industry verticals.

We generate customer leads, accelerate sales opportunities and build brand awareness through our marketing programs. Our marketing programs target sales, services, technology and finance executives within technology and technology-enabled health care and life sciences and industrial systems industries. Our marketing teams and programs are organized by geography and industry segment to focus on the unique needs of customers within the specific target markets.

We participate in industry trade shows and host local and regional events around the world to stimulate industry dialog on renewals and to promote ServiceSource products and services.

We are actively involved in the Service Executive Industry Board ("SEIB"), an independent industry board we founded to share best practices and address issues impacting the industry. The board members consist of 21 senior executives, including three of our executives, who manage and grow recurring revenue at leading technology-based hardware, software, and health care companies. SEIB meets regularly to establish industry standards and best practices for benchmarking and measuring the health of global maintenance, support and subscription recurring revenue and customer satisfaction.

### Research and Development

We focus our research and development efforts on enhancing our product and service offerings as well as complementary new capabilities as part of our proprietary solution. Our development strategy is to identify features, business intelligence, applications and other technology elements that are, or are expected to be, needed by service

sales professionals, customers, channel partners and end customers to optimize recurring revenue performance. We are also investing in the development of Renew OnDemand to serve our customers' needs and enable greater operational efficiencies in our organization.

Our research and development expenses were \$23.9 million in 2013, \$19.3 million in 2012 and \$13.1 million in 2011. In addition, we capitalized certain expenditures related to the development and enhancement of internal-use software in 2012 and 2011.

#### Competition

The market for recurring revenue management is evolving. Historically, technology companies have managed their service renewals through internal personnel and relied upon a variety of technologies including spreadsheets, internally developed software and customized versions of traditional business intelligence tools and customer relationship management or enterprise resource planning software from vendors such as Oracle, SAP, salesforce.com and NetSuite. Some companies have made further investments in this area using firms such as Accenture and McKinsey for technology consulting and education

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services focused on service renewals. These internally-developed solutions represent the primary alternative to our integrated approach of combining software, managed services and data to provide end-to-end optimized recurring revenue performance.

We believe the principal competitive factors in our markets include the following:

- recurring revenue industry expertise, best practices, and benchmarks;
- performance-based pricing of solutions;
- ability to increase recurring revenue and renewal rates;
- global capabilities;
- completeness of solution;
- ability to effectively represent customer brands to end customers and channel partners;
- size of upfront investment; and
- size and financial stability of operations.

Although we believe we compete or compare favorably with respect to many of these factors and currently have few direct competitors that offer integrated solutions at our scale, we expect competition and competitive pressure, from both new and existing competitors, to increase in the future.

### Intellectual Property

We rely upon a combination of copyrights, trade secrets and trademarks, in addition to contractual restrictions such as confidentiality agreements, to establish and protect our proprietary rights. We currently have one registered copyright in the United States, nine pending patent applications in the United States and two international patent applications. We also have registered trademarks for “ServiceSource” in the United States, the European Community, Japan, Singapore and Australia. In addition, we have registered trademarks and pending trademark applications for a number of product names in various jurisdictions.

Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy or obtain and use our technology and/or brand names to develop products with the same functionality as our solution. Policing unauthorized use of our technology is difficult. The laws of other countries in which we market our solutions may offer little or no effective protection of our proprietary technology. Our competitors could also independently develop technologies equivalent or superior to ours, and our intellectual property rights may not be broad enough for us to prevent competitors from selling products incorporating those technologies. Reverse engineering, unauthorized copying or other misappropriation of our proprietary technology could enable third parties to benefit from our technology without paying us for it, which would significantly harm our business.

We expect that technology solutions in our industry may be increasingly subject to third-party patent infringement claims as the number of competitors grows and the functionality of products in different industry segments overlaps. Such competitors could make a claim alleging that we infringe one or more of their patents, and we do not own any patents which could be asserted against them. Third parties may currently have, or may eventually be issued, patents upon which our current solution or future technology infringe. Any of these third parties might make a claim of infringement against us at any time.

### Employees

As of December 31, 2013, we had 2,914 employees. None of our employees is represented by a labor union with respect to his or her employment with us.



ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

Item 1A. Risk Factors

You should carefully consider the risks and uncertainties described below together with all the other information in this Annual Report on Form 10-K. If any of the following risks are realized, our business, financial condition, results of operations, cash flows, the trading price of our common stock could be materially and adversely affected. The risks described below are not the only risks facing us. Risks and uncertainties not currently known to us or that we currently deem to be immaterial may also materially affect our business, financial condition, results of operations, cash flows, the trading price of our common stock.

Risks Related to Our Business and Industry

Our quarterly results of operations may fluctuate as a result of numerous factors, many of which may be outside of our control.

Our quarterly operating results are likely to fluctuate. Some of the important factors that may cause our revenue, operating results and cash flows to fluctuate from quarter to quarter include:

- our ability to attract new customers;
- our ability to retain existing customers and/or maintain the size of our engagements with those customers;

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the renewal rates we achieve early in an engagement and the time it takes to achieve the close rates expected for the term of the engagement;

- our ability to effectively sell and implement Renew OnDemand;
- fluctuations in the value of end customer contracts delivered to us;
- fluctuations in close rates;
- changes in our commission rates;
- seasonality;
- loss of customers for any reason including due to acquisition;
- the mix of new customers as compared to existing customers;

the length of the sales cycle for our solution, and our level of upfront investments prior to the period we begin generating revenue associated with such investments;

- the timing of customer payments and payment defaults by customers;
- the amount and timing of operating costs and capital expenditures related to the operations of our business, including the development of new products such as Renew OnDemand;
- the rate of expansion, productivity and realignment of our direct sales force;

the cost and timing of the introduction of new technologies or new services, including additional investments in Renew OnDemand;

- general economic conditions;
- technical difficulties or interruptions in delivery of our solution;
- changes in foreign currency exchange rates;
- changes in tax rates;
- regulatory compliance costs, including with respect to data privacy;
- costs associated with acquisitions of companies and technologies;

changes in our stock price and the impact of such changes on our convertible notes and related note hedges and warrants;

- extraordinary expenses such as litigation or other dispute-related settlement payments; and

- the impact of new accounting pronouncements.

Many of the above factors are discussed in more detail elsewhere in these Risk Factors. Many of these factors are outside our control, and the variability and unpredictability of such factors could result in our failing to meet our revenue or operating results expectations for a given period. In addition, the occurrence of one or more of these factors might cause our operating results to vary widely which could lead to negative impacts on our margins, short-term liquidity or ability to retain or attract key personnel, and could cause other unanticipated issues. Accordingly, we believe that quarter-to-quarter comparisons of our revenue, operating results and cash flows may not be meaningful and should not be relied upon as an indication of future performance.

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Our customer relationships and overall business will suffer if our new Renew OnDemand platform does not meet expectations or if we encounter significant problems migrating customers to it.

In the fall of 2012, we introduced Renew OnDemand, our next-generation recurring revenue management platform. This new platform is offered on a subscription basis and will serve as the core foundation for our customer-facing cloud applications, in addition to applications we use for our internal operations. Renew OnDemand remains relatively new and we have less experience selling and/or implementing it for customers and migrating customers from our traditional platform to Renew OnDemand. Given the complexity and significance of this ongoing transition, including as a result of the amount of customer data within our systems that will need to be accessed and migrated, our customer relationships, our reputation, and our overall business could be severely damaged if our implementations or migrations are poorly executed. In addition, we expect to incur additional expenses as a result of our near term plans to run dual technology platforms as we move toward broad adoption of Renew OnDemand while maintaining our existing technology platform. Additionally, if we experience any delay or technical problems as a result of moving to Renew OnDemand, we may incur such expenses for much longer than anticipated. Similarly our business operations and customer relationships will be at high risk if Renew OnDemand does not meet our performance expectations, or those of our customers. This could harm our business in numerous ways including, without limitation, a loss of revenue and customer contracts and damage to our reputation.

Our revenue will decline if there is a decrease in the overall demand for our customers' products and services for which we provide recurring revenue management.

Our revenue is based on a pay-for-performance model under which we are paid a commission based on the service contracts we sell on behalf of our customers. If a particular customer's products or services fail to appeal to its end customers, our revenue may decline. In addition, if end customer demand decreases for other reasons, such as negative news regarding our customers or their products, unfavorable economic conditions, shifts in strategy by our customers away from promoting the service contracts we sell in favor of selling their other products or services to their end customers, or if end customers experience financial constraints and fail to renew the service contracts we sell, we may experience a decrease in our revenue as the demand for our customers' service contracts declines. Similarly, if our customers come under economic pressure, they may be more likely to terminate their contracts with us and/or seek to restructure those contracts, and for customers whose contracts are up for renewal, they may seek to renew those contracts on less favorable terms.

The market for our solution is relatively undeveloped and may not grow.

The market for recurring revenue management is still relatively undeveloped, has not yet achieved widespread acceptance and may not grow quickly or at all. Our success will depend to a substantial extent on the willingness of companies to engage a third party such as us to manage the sales of their support, maintenance and subscription contracts. Many companies have invested substantial personnel, infrastructure and financial resources in their own internal recurring revenue organizations-or in some cases have built or modified software applications to help manage renewals-and therefore may be reluctant to switch to a solution such as ours. Companies may not engage us for other reasons, including a desire to maintain control over all aspects of their sales activities and customer relations, concerns about end customer reaction, a belief that they can sell their support, maintenance and subscription services more cost-effectively using their internal sales organizations, perceptions about the expenses associated with changing to a new approach and the timing of expenses once they adopt a new approach, general reluctance to adopt any new and different approach to old ways of doing business, or other considerations that may not always be evident. New concerns or considerations may also emerge in the future. Particularly because our market is relatively undeveloped, we must address our potential customers' concerns and explain the benefits of our approach in order to convince them to change the way that they manage the sales of support, maintenance and subscription contracts. If companies are not

sufficiently convinced that we can address their concerns and that the benefits of our solution are compelling, then the market for our solution may not develop as we anticipate and our business will not grow.

Delayed or unsuccessful investment in new technology, services and markets may harm our financial results.

We plan to continue investing significant resources in research and development in order to enhance Renew OnDemand, our managed services offerings, and other new offerings that will appeal to customers and potential customers. We have undertaken the development of Renew OnDemand as our new technology to offer improved and more scalable recurring revenue management, including enhancements to our applications. The development of new products and services entails a number of risks that could adversely affect our business and operating results, including:

- the risk of diverting the attention of our management and our employees from the day-to-day operations of the business;

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- insufficient revenue to offset increased expenses associated with research, development, operational and marketing activities;
- write-offs of the value of such technology investments as a result of unsuccessful implementation of otherwise.

If Renew OnDemand or any of our other new or modified technology does not work as intended, is not responsive to user preferences or industry or regulatory changes, is not appropriately timed with market opportunity, or is not effectively brought to market, we may lose existing and potential customers or related recurring revenue opportunities, in which case our results of operations may suffer. The cost of future development of new recurring revenue management offerings or technologies also could require us to raise additional debt or equity financing. These actions could be dilutive to our stockholders and negatively impact our financial condition or our results of operations.

We sell subscriptions to our cloud applications via Renew OnDemand separately from our integrated solution, which may not be successful and could impact revenue from our existing solution.

We currently derive a small portion of our revenue from subscriptions to our cloud applications for a few customers, and we package and price the applications we offer on Renew OnDemand on a subscription model. We may not be able to fully develop a successful market for our Renew OnDemand subscription applications. In addition, because we have limited prior experience selling technology subscriptions on a stand-alone basis, we may encounter technical and execution challenges that undermine the quality of the technology offering or cause us to fall short of customer expectations. We also have little experience pricing our technology subscriptions separately, which could result in underpricing that damages our profit margins and financial performance. It is also possible that selling a technology solution separately via Renew OnDemand from our integrated solution will result in a reduction in sales of our current offerings that we might otherwise have sold. An unsuccessful expansion of our business to promote a stand-alone subscription model for any of the foregoing reasons or otherwise would lead to a diversion of financial and managerial resources from our existing business and an inability to generate sufficient revenue to offset our investment costs.

Our estimates of recurring revenue opportunity under management and other metrics may prove inaccurate.

We use various estimates in formulating our business plans and analyzing our potential and historical performance, including our estimate of recurring revenue opportunity under management. We base our estimates upon a number of assumptions that are inherently subject to significant business and economic uncertainties and contingencies, many of which are beyond our control. Our estimates therefore may prove inaccurate.

Recurring revenue opportunity under management (“opportunity under management”) is a forward-looking metric and is our estimate, as of a given date, of the value of all end customer service contracts that we will have the opportunity to sell or provide sales support on behalf of our customers over the subsequent twelve-month period. Opportunity under management is not a measure of our expected revenue. 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 customers in past periods; the minimum value of end-customer contracts that our customers are required to give us the opportunity to sell pursuant to the terms of their contracts with us; periodic internal business reviews of our expectations as to the value of end customer contracts that will be made available to us by customers; the value of end customer contracts included in the SPA; and collaborative discussions with our customers assessing their expectations as to the value of service contracts that they will make available to us for sale. While the minimum value of end customer contracts that our customers 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. When estimating recurring revenue opportunity under management and other similar metrics, 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 twelve-month period to differ from our estimate of opportunity under management. These factors include:

- the extent to which customers deliver a greater or lesser value of end customer contracts than may be required or otherwise expected;
- roll-overs of unsold service contract renewals from prior periods to the current period or future periods;
- changes in the pricing or terms of service contracts offered by our customers;
- increases or decreases in the end customer base of our customers;

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- the extent to which the renewal rates we achieve on behalf of a customer early in an engagement affect the amount of opportunity that the customer makes available to us later in the engagement;
- customer cancellations of their contracts with us due to acquisitions or otherwise; and
- changes in our customers' businesses, sales organizations, sales processes or priorities, including changes in executive support for our partnership.

In addition, opportunity under management reflects our estimate for a forward twelve-month period and should not be used to estimate our opportunity for any particular quarter within that period.

If our security measures are breached or fail, resulting in unauthorized access to customer data, our solution may be perceived as insecure, the attractiveness of our solution to current or potential customers may be reduced and we may incur significant liabilities.

Our solution involves the storage and transmission of the proprietary information and protected data that we receive from our customers. We rely on proprietary and commercially available systems, software, tools and monitoring, as well as other processes, to provide security for processing, transmission and storage of such information. If our security measures are breached or fail as a result of third-party action, employee negligence, error, malfeasance or otherwise, unauthorized access to customer or end customer data may occur. Improper activities by third parties, advances in computer and software capabilities and encryption technology, new tools and discoveries and other events or developments may facilitate or result in a compromise or breach of our computer systems. Techniques used to obtain unauthorized access or to sabotage systems change frequently and generally are not recognized until launched against a target, and we may be unable to anticipate these techniques or implement adequate protective measures. Our security measures may not be effective in preventing these types of activities, and the security measures of our third-party data centers and service providers may not be adequate.

Our customer contracts generally provide that we will indemnify our customers for data privacy breaches. If such a breach occurs, we could face contractual damages, damages and fees arising from our indemnification obligations, penalties for violation of applicable laws or regulations, possible lawsuits by affected individuals and significant remediation costs and efforts to prevent future occurrences. In addition, whether there is an actual or a perceived breach of our security, the market perception of the effectiveness of our security measures could be harmed significantly and we could lose current or potential customers.

We may be liable to our customers or third parties if we make errors in providing our solution or fail to properly safeguard our customers' confidential information.

The solution we offer is complex, and we make errors from time to time. These may include human errors made in the course of managing the sales process for our customers as we interact with their end customers, or errors arising from our technology solution as it interacts with our customers' systems and the disparate data contained on such systems. Errors may also arise from the launch of and migration of our offerings to Renew OnDemand. The costs incurred in correcting any material errors may be substantial. In addition, as part of our business, we collect, process and analyze confidential information provided by our customers and prospective customers. Although we take significant steps to safeguard the confidentiality of customer information, we could be subject to claims that we disclosed their information without appropriate authorization or used their information inappropriately. Any claims based on errors or unauthorized disclosure or use of information could subject us to exposure for damages, significant legal defense



costs, adverse publicity and reputational harm, regardless of the merits or eventual outcome of such claims.

If close rates fall short of our estimates, our customer relationships will be at risk, our revenue will suffer and our ability to grow and achieve broader market acceptance of our solution could be harmed.

Given our pay-for-performance pricing model, our revenue is directly tied to close rates. Close rates represent the percentage of the actual opportunity delivered that we renew on behalf of our customers. If the close rate for a particular customer is lower than anticipated, then our revenue for that customer will also be lower than projected. If close rates fall short of expectations across a broad range of customers, or if they fall below expectations for a particularly large customer, then the impact on our revenue and our overall business will be significant. In the event close rates are lower than expected for a given customer, our margins will suffer because we will have already incurred a certain level of costs in both personnel and infrastructure to support the engagement. This risk is compounded by the fact that many of our customer relationships are terminable if we fail to meet certain specified sales targets over a sustained period of time. If actual close rates fall to a level at which our revenue and customer contracts are at risk, then our financial performance will decline and we will be severely

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compromised in our ability to retain and attract new customers. Increasing our customer base and achieving broader market acceptance of our solution depends, to a large extent, on how effectively our solution increases service sales. As a result, poor performance with respect to our close rates, in addition to causing our revenue, margins and earnings to suffer, will likely damage our customer relationships and overall reputation, and prevent us from effectively developing and maintaining awareness of our brand or achieving widespread acceptance of our solution, in which case we could fail to grow our business and our revenue, margins and earnings would suffer.

If we continue to see turnover of our top executives, or if we are unable to attract, hire, integrate and retain key personnel and other necessary employees, our business will be harmed.

We have incurred turnover in some key executive positions in 2013. Our future success depends on the continued contributions of our executives, each of whom may be difficult to replace. Our future success also depends in part on our ability to attract, hire, integrate and retain qualified service sales personnel, sales representatives and management-level employees to oversee such sales forces in addition to marketing, research and development and general and administrative personnel to support our global operation. In particular, Michael Smerklo, our chairman of the board of directors and chief executive officer, is critical to the management of our business and operations and the development of our strategic direction. The loss of Mr. Smerklo's services or those of our other executives, or our inability to continue to attract and retain high-quality talent, could harm our business.

If we are unable to compete effectively against current and future competitors, our business and operating results will be harmed.

The market for recurring revenue management continues to evolve. Historically, technology companies have managed their service renewals through internal personnel and relied upon technology ranging from Excel spreadsheets to internally-developed software to customized versions of traditional business intelligence tools and CRM or ERP software from vendors such as Oracle, SAP, salesforce.com and NetSuite. Some companies have made further investments in this area using firms such as Accenture and McKinsey for technology consulting and education services focused on service renewals. These internally-developed solutions represent the primary alternative to our offerings. We also face direct competition from smaller companies that offer specialized recurring revenue management solutions, typically providing technology for use by their customers' internal sales personnel. We believe the principal competitive factors in our markets include the following:

- recurring revenue industry expertise, best practices, and benchmarks;
- quality and reliability of software offerings;
- marketing resources and capabilities;
- performance-based pricing of solutions;
- ability to increase recurring revenue, renewal rates, and close rates;
- global capabilities;
- completeness of solution;
- ability to effectively represent customer brands to end customers and channel partners;

- size of upfront investment; and
- size and financial stability of operations.

We believe that more competitors will emerge. These competitors may have greater name recognition, longer operating histories, well-established relationships with customers in our markets and substantially greater financial, technical, personnel and other resources than we have. Potential competitors of any size may be able to respond more quickly and effectively than we can to new or changing opportunities, technologies, standards or customer or end customer requirements. Even if our solution is more effective than competing solutions, potential customers might choose new entrants unless we can convince them of the advantages of our integrated solution. We expect competition and competitive pressure, from both new and existing competitors, to increase in the future.

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If there is a widespread shift away from business customers purchasing maintenance and support service contracts, we could be adversely impacted if we are not able to adapt to new trends or expand our target markets.

As a result of our historical concentration in the software and hardware industries, a significant portion of our revenue comes from the sale of maintenance and support service contracts for the software and hardware products used by our customers' end customers. Although we also sell other types of renewals, such as subscriptions to software-as-a-service offerings, those sales have to date constituted a relatively small portion of our revenue. The emergence of cloud computing and other alternative technology purchasing models, in which technology services are provided on a remote-access basis, may have a significant impact on the size of the market for traditional maintenance and support contracts. If these alternative models continue gaining traction and reduce the size of our traditional market, we will need to continue to adapt our solution to capitalize on these trends or our results of operations will suffer.

The loss of one or more of our key customers could slow our revenue growth or cause our revenue to decline.

A substantial portion of our revenue has to date come from a relatively small number of customers. During the twelve months ended December 31, 2013, our top ten customers accounted for 50% of our revenue with one customer representing over 10% of our revenue. A relatively small number of customers may continue to account for a significant portion of our revenue for the foreseeable future. The loss of any of our significant customers for any reason, including the failure to renew our contracts, a change of relationship with any of our key customers or their acquisition as discussed below, may cause a significant decrease in our revenue.

Supporting our existing and growing customer base could strain our personnel resources and infrastructure, and if we cannot scale our operations and increase productivity, we may be unsuccessful in implementing our business plan.

Anticipated growth in our customer base will place a strain on our management, administrative, operational and financial infrastructure. We expect that additional investments in sales personnel, information technology, infrastructure and research and development spending will be required to:

- further develop and enhance Renew OnDemand and our other offerings;
- address the needs of our customers;
- scale our operations and increase productivity;
- develop new technology; and
- expand our markets and opportunity under management, including into new industry verticals and geographic areas.

Our success will depend in part upon our ability to manage our growth effectively. To do so, we must continue to increase the productivity of our existing employees and to hire, train and manage new employees as needed. To manage domestic and international growth of our operations and personnel, we will need to continue to improve our operational, financial and management controls and our reporting processes and procedures, and implement more extensive and integrated financial and business information systems. These additional investments will increase our operating costs, which will make it more difficult for us to offset any future revenue shortfalls by reducing expenses in the short term. Moreover, if we fail to scale our operations successfully and increase productivity, our overall business will be at risk.

Consolidation in the technology sector is continuing at a rapid pace, which could harm our business in the event that our customers are acquired and their contracts are cancelled.

Consolidation among technology companies in our target market has been robust in recent years, and this trend poses a risk for us. Acquisitions of our customers could lead to cancellation of our contracts with those customers by the acquiring companies and could reduce the number of our existing and potential customers. For example, Oracle has acquired a number of our customers in recent years, including our then-largest customer, Sun Microsystems, in January 2010. Oracle has elected to terminate our service contracts with each customer because Oracle conducts its recurring revenue management internally. If mergers and acquisitions continue, we expect that some of the acquiring companies, and Oracle in particular, will terminate, renegotiate and/or elect not to renew our contracts with the companies they acquire, which would reduce our revenue.

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Our business and growth depend substantially on customers renewing their agreements with us and expanding their use of our solution for additional available markets. Any decline in our customer renewals or failure to expand their relationships with us could harm our future operating results.

In order for us to improve our operating results and grow, it is important that our customers renew their agreements with us when the initial contract term expires and that we expand our customer relationships to add new market opportunities and the related recurring revenue opportunity under management. Our customers may elect not to renew their contracts with us after their initial terms have expired, and we cannot assure you that our customers will renew service contracts with us at the same or higher level of service, if at all, or provide us with the opportunity to manage additional opportunity. Although our renewal rates have been historically higher than those achieved by our customers prior to their using our solution, some customers have elected not to renew their agreements with us. Our customers' renewal rates may decline or fluctuate as a result of a number of factors, including their satisfaction or dissatisfaction with our solution and results, our pricing, mergers and acquisitions affecting our customers or their end customers, the effects of economic conditions or reductions in our customers' or their end customers' spending levels. In addition our unbundled solution offers the ability for customers to keep fewer offerings and contract out of other services. If our customers do not renew their agreements with us in full, renew on less favorable terms or fail to contract with us for additional recurring revenue management opportunities, our revenue may decline and our operating results may be adversely affected.

We enter into long-term, commission-based contracts with our customers, and our failure to correctly price these contracts may negatively affect our profitability.

We enter into long-term contracts with our customers that are priced based on multiple factors determined in large part by the SPA we conduct for our customers. These factors include opportunity size, anticipated close rates and expected commission rates at various levels of sales performance. Some of these factors require forward-looking assumptions that may prove incorrect. If our assumptions are inaccurate, or if we otherwise fail to correctly price our customer contracts, particularly those with lengthy contract terms, then our revenue, profitability and overall business operations may suffer. Further, if we fail to anticipate any unexpected increase in our cost of providing services, including the costs for employees, office space or technology, we could be exposed to risks associated with cost overruns related to our required performance under our contracts, which could have a negative effect on our margins and earnings.

Many of our managed services customer contracts allow termination for our failure to meet certain performance conditions.

Although most of our managed services customer contracts are subject to multi-year terms, these agreements often have termination rights if we fail to meet specified sales targets. During the SPA and contract negotiation phase with a customer, we typically negotiate minimum performance levels for the engagement. If we fail to meet our required targets and our customers choose to exercise their termination rights, our revenue could decline. These termination rights may also create instability in our revenue forecasts and other forward-looking financial metrics.

Our business may be harmed if our customers rely upon our recurring revenue forecasts in their business and actual results are materially different.

The contracts that we enter into with our customers provide for sharing of information with respect to forecasts and plans for the renewal of maintenance, support and subscription agreements of our customers. Our customers may use such forecasted data for a variety of purposes related to their business. Our forecasts are based upon the data our customers provide to us, and are inherently subject to significant business, economic and competitive uncertainties,

many of which are beyond our control.

In addition, these forecasted expectations are based upon historical trends and data that may not be true in subsequent periods. Any material inaccuracies related to these forecasts could lead to claims on the part of our customers related to the accuracy of the forecasted data we provide to them, or the appropriateness of our methodology. Any liability that we incur or any harm to our brand that we suffer because of inaccuracies in the forecasted data we provide to our customers could impact our ability to retain existing customers and harm our business.

Changing global economic conditions and large scale economic shifts may impact our business.

Our overall performance depends in part on worldwide economic conditions that impact the technology sector and other technology-enabled industries such as health care, life sciences and industrial systems. For example, the recent economic downturn resulted in many businesses deferring technology investments, including purchases of new software, hardware and other equipment, and purchases of additional or supplemental maintenance, support and subscription services. To a certain extent, these businesses also slowed the rate of renewals of maintenance, support and subscription services for their existing technology base. A future downturn could cause business customers to stop renewing their existing maintenance, support and

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subscription agreements or contracting for additional maintenance services as they look for ways to further cut expenses, in which case our business could suffer.

Conversely, a significant upturn in global economic conditions could cause business purchasers to purchase new hardware, software and other technology products, which we generally do not sell, instead of renewing or otherwise purchasing maintenance, support and subscription services for their existing products. A general shift toward new product sales could reduce our near term opportunities for these contracts, which could lead to a decline in our revenue.

Changes in the U.S. and foreign legal and regulatory environment that affect our operations, including those relating to privacy, data security and cross-border data flows, could pose a significant risk to us by disrupting our business and increasing our expenses.

We are subject to a wide variety of laws and regulations in the United States and the other jurisdictions in which we operate, and changes in the level of government regulation of our business have the potential to materially alter our business practices with resultant increases in costs and decreases in profitability. Depending on the jurisdiction, those changes may come about through new legislation, the issuance of new regulations or changes in the interpretation of existing laws and regulations by a court, regulatory body or governmental official. Sometimes those changes have both prospective and retroactive effect, which is particularly true when a change is made through reinterpretation of laws or regulations that have been in effect for some time.

Privacy and data security are rapidly evolving areas of regulation, and additional regulation in those areas, some of it potentially difficult and costly for us to accommodate, is frequently proposed and occasionally adopted. Laws in many countries and jurisdictions, particularly in the European Union and Canada, govern the requirements related to how we store, transfer or otherwise process the private data provided to us by our customers. In addition, the centralized nature of our information systems at the data and operations centers that we use requires the routine flow of data relating to our customers and their respective end customers across national borders, both with respect to the jurisdictions within which we have operations and the jurisdictions in which we provide services to our customers. If this flow of data becomes subject to new or different restrictions, our ability to serve our customers and their respective customers could be seriously impaired for an extended period of time. For example, we participate in the U.S. Department of Commerce Safe Harbor Framework to govern our treatment of data and data flow with respect to our customers and their respective customers across various jurisdictions. We also have entered into various model contracts and related contractual provisions to enable these data flows. For any jurisdictions in which these measures are not recognized or otherwise not compliant with the laws of the countries in which we process data, or where more stringent data privacy laws are enacted irrespective of international treaty arrangements or other existing compliance mechanisms, we could face increased compliance expenses and face penalties for violating such laws or be excluded from those markets altogether, in which case our operations could be materially damaged.

Our inability to expand our target markets could adversely impact our business and operating results.

We derive substantially all of our revenue from customers in certain sectors in the technology and technology-enabled health care and life sciences industries, and an important part of our strategy is to expand our existing customer base and win new customers in these industries. In addition, because of the recurring revenue opportunities that we believe exist beyond these industries, we intend to target new customers in additional industry vertical markets, such as technology-enabled building services. In connection with the expansion of our target markets, we may not have familiarity with such additional industry verticals, and our execution of such expansion could face risks where our experience base is less developed within a particular new vertical. We may encounter customers in these previously untapped markets that have different pricing and other business sensitivities than we are used to managing. As a result of these and other factors, our efforts to expand our solution to additional industry vertical markets may not succeed, may divert management resources from our existing operations and may require us to commit significant financial



resources to unproven parts of our business, all of which may harm our financial performance.

A substantial portion of our business consists of supporting our customers' channel partners in the sale of service contracts. If those channel partners become unreceptive to our solution, our business could be harmed.

Many of our customers, including some of our largest customers, sell service contracts through their channel partners and engage our solution to help those channel partners become more effective at selling service contract renewals. These channel partners may have access to some of our cloud applications, such as our Channel Sales Cloud, in addition to other sales support services we provide. In this context, the ultimate buyers of the service contracts are end customers of those channel partners, who then receive the actual services from our customers. In the event our customers' channel partners become unreceptive to our involvement in the renewals process, those channel partners could discourage our current or future customers from engaging our solution to support channel sales. This risk is compounded by the fact that large channel partners may have relationships with more than one of our customers or prospects, in which case the negative reaction of one or more of those

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large channel partners could impact multiple customer relationships. Accordingly, with respect to those customers and prospective customers who sell service contracts through channel partners, any significant resistance to our solution by their channel partners could harm our ability to attract or retain customers, which would damage our overall business operations.

We face long sales cycles to secure new customer contracts, making it difficult to predict the timing of specific new customer relationships.

We face a variable selling cycle to secure new customer agreements, typically spanning a number of months and requiring our effort to obtain and analyze our prospect's business through the SPA, for which we are not paid. We recently have also experienced a lengthening of our sales cycles reflecting the hiring of a number of new sales personnel in the past eighteen months who are new to selling our solution as well as slower decision making by a few end customers as well as other end customers considering renewals of large, multi-year contracts. This has adversely affected the conversion rates of new customer contracts. Moreover, even if we succeed in developing a relationship with a potential new customer, the scope of the potential subscription or recurring revenue management engagement frequently changes over the course of the business discussions and, for a variety of reasons, our sales discussions may fail to result in new customer acquisitions. Consequently, we have only a limited ability to predict the timing and size of specific new customer relationships.

If we experience significant fluctuations in our anticipated growth rate and fail to balance our expenses with our revenue forecasts, our results could be harmed.

Due to our evolving business model, the uncertain size of our markets and the unpredictability of future general economic and financial market conditions, we may not be able to accurately forecast our growth rate. We plan our expense levels and investments based on estimates of future sales performance for our customers with respect to their end customers, future revenue and future customer acquisition. If our assumptions prove incorrect, we may not be able to adjust our spending quickly enough to offset the resulting decline in growth and revenue. Consequently, we expect that our gross margins, operating margins and cash flows may fluctuate significantly on a quarterly basis.

If we cannot efficiently implement our offering for customers, we may be delayed in generating revenue, fail to generate revenue and/or incur significant costs.

In general, our customer engagements are complex and may require lengthy and significant work to implement our offerings. We also have less experience implementing our Renew OnDemand platform. As a result, we generally incur sales and marketing expenses related to the commissions owed to our sales representatives and make upfront investments in technology and personnel to support the engagements one to three months before we begin selling end customer contracts. Each customer's situation may be different, and unanticipated difficulties and delays may arise as a result of our failure, or that of our customer, to meet respective implementation responsibilities. If the customer implementation process is not executed successfully or if execution is delayed, we could incur significant costs without yet generating revenue, and our relationships with some of our customers may be adversely impacted.

Because competition for our target employees is intense, we may be unable to attract and retain the highly skilled employees we need to support our planned growth.

To continue to execute on our growth plan, we must attract and retain highly qualified sales representatives, engineers and other key employees in the markets in which we have operations. Competition for these personnel is intense, especially for highly educated, qualified sales representatives. We have from time to time in the past experienced, and we expect to continue to experience in the future, difficulty in hiring and retaining highly skilled key employees with

appropriate qualifications. If we fail to attract new sales representatives, engineers and other key employees, or fail to retain and motivate our most successful employees, our business and future growth prospects could be harmed.

The length of time it takes our newly-hired sales representatives to become productive could adversely impact our success rate, the execution of our overall business plan and our costs.

It can take twelve months or longer before our internal sales representatives are fully trained and productive in selling our solution to prospective customers. This long ramp period presents a number of operational challenges as the cost of recruiting, hiring and carrying new sales representatives cannot be offset by the revenue such new sales representatives produce until after they complete their long ramp periods. Further, given the length of the ramp period, we often cannot determine if a sales representative will succeed until he or she has been employed for a year or more. If we cannot reliably develop our sales representatives to a productive level, or if we lose productive representatives in whom we have heavily invested, our future growth rates and revenue will suffer.

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We depend on revenue from sources outside the United States, and our international business operations and expansion plans are subject to risks related to international operations, and may not increase our revenue growth or enhance our business operations.

For the year ended December 31, 2013, approximately 36% of our revenue was generated from sales centers located outside of the United States. As a result of our continued focus on international markets, we expect that revenue derived from international sources will continue to represent a significant portion of our total revenue.

A portion of the sales commissions earned from our international customers is paid in currencies. As a result, fluctuations in the value of these foreign currencies may make our solution more expensive or cause resulting fluctuations in cost for international customers, which could harm our business. We currently do not undertake hedging activities to manage these currency fluctuations. In addition, if the effective price of the contracts we sell to end customers were to increase as a result of fluctuations in the exchange rate of the relevant currencies, demand for such contracts could fall, which in turn would reduce our revenue.

Our growth strategy includes further expansion into international markets. Our international expansion may require significant additional financial resources and management attention, and could negatively affect our financial condition, cash flows and operating results. In addition, we may be exposed to associated risks and challenges, including:

- the need to localize and adapt our solution for specific countries, including translation into foreign languages and associated expenses;
- difficulties in staffing and managing foreign operations;
- different pricing environments, longer sales cycles and longer accounts receivable payment cycles and difficulties in collecting accounts receivable;
- new and different sources of competition;
- weaker protection for our intellectual property than in the United States and practical difficulties in enforcing our rights abroad;
- laws and business practices favoring local competitors;
- compliance obligations related to multiple, conflicting and changing foreign and U.S. governmental laws and regulations, including employment, tax, privacy, data protection, foreign currency controls and anti-bribery laws and regulations;
- increased financial accounting and reporting burdens and complexities;
- restrictions on the transfer of funds;
- adverse tax consequences; and
- unstable regional economic and political conditions.

We cannot assure you we will succeed in creating additional international demand for our solution or that we will be able to effectively sell service agreements in the international markets we enter.

We incur increased costs and demands upon management as a result of complying with the laws and regulations affecting public companies, which could adversely affect our operating results.

As a public company, we incur significant legal, accounting and other expenses, and greater expenditures may be necessary in the future with the advent of new laws, regulations and stock exchange listing requirements pertaining to public companies. The Sarbanes-Oxley Act of 2002 and the Dodd-Frank Act of 2010, as well as rules subsequently implemented by the Securities and Exchange Commission and The NASDAQ Stock Market LLC, impose various requirements on companies, including establishing effective internal controls and certain corporate governance practices. Our management and other personnel devote a substantial amount of time to these compliance initiatives, and additional laws and regulations may divert further management resources. Moreover, if we are not able to meet new compliance requirements in a timely manner, the market price of our stock could decline, and we could be subject to investigations and other actions by The NASDAQ Stock

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Market LLC, the Securities and Exchange Commission, or other regulatory authorities, which would require additional financial and management resources.

While we believe we currently have adequate internal control over financial reporting, we are required to evaluate our internal control over financial reporting under Section 404 of the Sarbanes-Oxley Act of 2002 and any adverse results from such evaluation could result in a loss of investor confidence in our financial reports and have an adverse effect on our stock price.

Under Section 404 of the Sarbanes-Oxley Act, we are required to furnish a report by our management on our internal control over financial reporting. The report contains, among other matters, an assessment of the effectiveness of our internal control over financial reporting as of the end of our fiscal year, including a statement as to whether or not our internal control over financial reporting is effective. This assessment must include disclosure of any material weaknesses in our internal control over financial reporting identified by management.

We monitor and assess our internal control over financial reporting, and if our management identifies one or more material weaknesses in our internal control over financial reporting and such weakness remains uncorrected at year-end, we will be unable to assert such internal control is effective at such time. If we are unable to assert that our internal control over financial reporting is effective at year-end (or if our independent registered public accounting firm is unable to express an opinion on the effectiveness of our internal controls over financial reporting or concludes that we have a material weakness in our internal controls), we could lose investor confidence in the accuracy and completeness of our financial reports, which would likely have an adverse effect on our business and stock price.

If we do not adequately protect our intellectual property rights, our competitive position and our business may suffer.

We rely upon a combination of patent, trademark, copyright and trade secret law and contractual terms to protect our intellectual property rights, all of which provide only limited protection. Our success depends, in part, upon our ability to establish, protect and enforce our intellectual property and other proprietary rights. If we fail to protect or effectively enforce our intellectual property rights, others may be able to compete against us using intellectual property that is the same as or similar to our own. In addition, we cannot assure you that our intellectual property rights are sufficient to provide us with a competitive advantage against others who offer services similar to ours. While we have filed patent applications to protect our intellectual property, we cannot assure you that any patents will issue or that any issued patents arising from our applications will provide the protection we seek, or that any future patents issued to us will not be challenged, invalidated or circumvented. Also, we cannot assure you that we will obtain any copyright or trademark registrations from our pending or future applications or that any of our trademarks will be enforceable or provide adequate protection of our proprietary rights. We also rely in some circumstances on trade secrets to protect our technology. Trade secrets may lose their value if not properly protected. We endeavor to enter into non-disclosure agreements with our employees, customers, contractors and business partners to limit access to and disclosure of our proprietary information. The steps we have taken, however, may not prevent unauthorized use of our technology, and adequate remedies may not be available in the event of unauthorized use or disclosure of our trade secrets and proprietary technology. However, trade secret protection does not prevent others from reverse engineering or independently developing similar technologies. In addition, reverse engineering, unauthorized copying or other misappropriation of our trade secrets could enable third parties to benefit from our technology without paying for it.

Accordingly, despite our efforts, we may be unable to prevent third parties from infringing or misappropriating our intellectual property and using our technology for their competitive advantage. Any such infringement or misappropriation could have a material adverse effect on our business, results of operations and financial condition. Monitoring infringement of our intellectual property rights can be difficult and costly, and enforcement of our intellectual property rights may require us to bring legal actions against infringers. Infringement actions are inherently uncertain and therefore may not be successful, even when claims are meritorious. Even if such actions are successful,

they may require a substantial amount of resources and divert our management's attention.

Claims by others that we infringe or violate their intellectual property could force us to incur significant costs and require us to change the way we conduct our business.

Numerous technology companies including potential competitors protect their intellectual property rights by means such as patents, trade secrets, copyrights and trademarks. We have not conducted an independent review of patents issued to third parties. Additionally, because patent applications in the United States and many other jurisdictions are kept confidential for some period of time before they are published, we may be unaware of pending patent applications that relate to our proprietary technology. From time to time we may receive letters from other parties alleging, or inquiring about, possible breaches of their intellectual property rights.

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Any party asserting that we infringe its proprietary rights would force us to defend ourselves, and possibly our customers, against the alleged infringement. The technology industry is characterized by the existence of a large number of patents, copyrights, trademarks and trade secrets and by frequent litigation based on allegations of infringement or other violations of intellectual property rights. Moreover, the risk of such a lawsuit will likely increase as we become larger, the scope of our solution and technology expands and the number of competitors in our market increases. Any such claims or litigation could:

- be time-consuming and expensive to defend, and deplete our financial resources, whether meritorious or not;
- require us to stop providing the services that use the technology that infringes the other party's intellectual property;
- divert the attention of our technical and managerial resources away from our business;
- require us to enter into royalty or licensing agreements with third parties, which may not be available on terms that we deem acceptable, if at all;
- prevent us from operating all or a portion of our business or force us to redesign our technology, which could be difficult and expensive and may make the performance or value of our solution less attractive;
- subject us to significant liability for damages or result in significant settlement payments; or
- require us to indemnify our customers as we are required by contract to indemnify some of our customers for certain claims based upon the infringement or alleged infringement of any third party's intellectual property rights resulting from our customers' use of our intellectual property.

During the course of any intellectual property litigation, confidential information may be disclosed in the form of documents or testimony in connection with discovery requests, depositions or trial testimony. Disclosure of our confidential information and our involvement in intellectual property litigation could harm us. In addition, any uncertainties resulting from the initiation and continuation of any litigation could significantly limit our ability to continue our operations and could harm our relationships with current and prospective customers. Any of the foregoing could disrupt our business and have a material adverse effect on our operating results and financial condition.

In addition, we may incorporate open source software into our technology solution. The terms of many open source licenses have not been interpreted by United States or foreign courts, and there is a risk that such licenses could be construed in a manner that imposes unanticipated conditions or restrictions on our commercialization of any of our solutions that may include open source software. As a result, we will be required to analyze and monitor our use of open source software closely. As a result of the use of open source software, we could be required to seek licenses from third parties in order to develop such future products, re-engineer our products, discontinue sales of our solutions or release our software code under the terms of an open source license to the public. Given the nature of open source software, there is also a risk that third parties may assert copyright and other intellectual property infringement claims against us based on any use of such open source software, as more generally discussed with respect to general intellectual property claims.

Various risks could affect our worldwide operations, including numerous events outside of our control, exposing us to significant costs that could adversely affect our operations and customer confidence.



We conduct operations throughout the world, including our headquarters in the United States and operations in Ireland, Malaysia, Singapore, Japan and the United Kingdom. Such worldwide operations expose us to potential operational disruptions and costs as a result of a wide variety of events, including local inflation or economic downturn, currency exchange fluctuations, political turmoil, labor issues, terrorism, natural disasters and pandemics. Any such disruptions or costs could have a negative effect on our ability to provide our solution or meet our contractual obligations, the cost of our solution, customer satisfaction, our ability to attract or maintain customers, and, ultimately, our profits.

Natural disasters or other catastrophic events may cause damage or disruption to our operations, international commerce and the global economy, and thus could have a strong negative effect on us. Our business operations are subject to interruption by natural disasters, fire, power shortages, pandemics and other events beyond our control. Such events could make it difficult or impossible for us to deliver our solution to our customers, and could decrease demand for our solution. The majority of our research and development activities, corporate headquarters, information technology systems and other critical business operations are located near major seismic faults in the San Francisco Bay Area. Because we may not have insurance coverage that would cover quake-related losses, and significant recovery time could be required to resume operations, our financial condition and operating results could be materially adversely affected in the event of a major earthquake or catastrophic event.

Terrorist attacks and other acts of violence or war may adversely affect worldwide financial markets and could potentially lead to economic recession, which could adversely affect our business, results of operations, financial condition and cash flows.

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These events could adversely affect our customers' levels of business activity and precipitate sudden significant changes in regional and global economic conditions and cycles.

The technology we currently use may not operate properly, which could damage our reputation, give rise to claims against us or divert application of our resources from other purposes, any of which could harm our business and operating results.

The technology we currently use, which includes our Renew OnDemand platform, may contain or develop unexpected defects or errors. There can be no assurance that performance problems or defects in our technology will not arise in the future. Errors may result from receipt, entry or interpretation of customer or end customer information or from the interface of our technology with legacy systems and data that are outside of our control. Despite testing, defects or errors may arise in our solution. Any defects and errors that we discover in our technology and any failure by us to identify and effectively address them could result in loss of revenue or market share, liability to customers or others, failure to achieve market acceptance or expansion, diversion of development resources, injury to our reputation, and increased costs. Defects or errors in our technology may discourage existing or potential customers from contracting with us. Correction of defects or errors could prove impossible or impracticable. The costs incurred in correcting any defects or errors or in responding to resulting claims or liability may be substantial and could adversely affect our operating results.

Disruptions in service or damage to the data center that hosts our data and our locations could adversely affect our business.

Our operations depend on our ability to maintain and protect our data servers and cloud applications, which are located in data centers operated for us by third parties. We cannot control or assure the continued or uninterrupted availability of these third-party data centers. In addition, our information technologies and systems, as well as our data center, are vulnerable to damage or interruption from various causes, including natural disasters, war and acts of terrorism and power losses, computer systems failures, Internet and telecommunications or data network failures, operator error, losses of and corruption of data and similar events. Although we conduct business continuity planning and maintain certain insurance for certain events, the situations for which we plan, and the amount of insurance coverage we maintain, may prove inadequate in any particular case. In addition, the occurrence of any of these events could result in interruptions, delays or cessations in the delivery of the solutions we offer to our customers. Any of these events could impair or prohibit our ability to provide our solution, reduce the attractiveness of our solution to current or potential customers and adversely impact our financial condition and results of operations.

In addition, despite the implementation of security measures, our infrastructure, data centers, operations and other centers or systems that we interface with, including the Internet and related systems, may be vulnerable to physical intrusions, hackers, improper employee or contractor access, computer viruses, programming errors, denial-of-service attacks or other attacks by third parties.

Any failure or interruptions in the Internet infrastructure, bandwidth providers, data center providers, other third parties or our own systems for providing our solution to customers could negatively impact our business.

Our ability to deliver our solution is dependent on the development and maintenance of the infrastructure of the Internet and other telecommunications services by third parties. Such services include maintenance of a reliable network backbone with the necessary speed, data capacity and security for providing reliable Internet access and services and reliable telecommunications systems that connect our global operations. While our solution is designed to operate without interruption, we have experienced and expect that we will in the future experience interruptions and delays in services and availability from time to time. We rely on internal systems as well as third-party vendors,

including data center, bandwidth, and telecommunications equipment providers, to provide our solution. We do not maintain redundant systems or facilities for some of these services. In the event of a catastrophic event with respect to one or more of these systems or facilities, we may experience an extended period of system unavailability, which could negatively impact our relationship with our customers.

Additional government regulations may reduce the size of the market for our solution, harm demand for our solution and increase our costs of doing business.

Any changes in government regulations that impact our customers or their end customers could have a harmful effect on our business by reducing the size of our addressable market or otherwise increasing our costs. For example, with respect to our technology-enabled health care and life sciences customers, any change in U.S. Food and Drug Administration or foreign equivalent regulation of, or denial, withholding or withdrawal of approval of, our customers' products could lead to a lack of demand for recurring revenue management with respect to such products. Other changes in government regulations, in areas such as privacy, export compliance or anti-bribery statutes, such as the U.S. Foreign Corrupt Practices Act, could require us to

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implement changes in our services or operations that increase our cost of doing business and thereby hurt our financial performance.

The future success of our business depends upon the continued use of the Internet as a primary medium for commerce, communication and business applications. Federal, state or foreign government bodies or agencies have in the past adopted, and may in the future adopt, laws or regulations affecting data privacy and the use of the Internet as a commercial medium. In addition, government agencies or private organizations may begin to impose taxes, fees or other charges for accessing the Internet. These laws or charges could limit the growth of Internet-related commerce or communications generally, result in a decline in the use of the Internet and the viability of Internet-based applications such as ours and reduce the demand for our solution.

We operate and offer our services in many jurisdictions and, therefore, may be subject to state, local and foreign taxes that could harm our business.

We operate service sales centers in multiple locations. Some of the jurisdictions in which we operate, such as Ireland, give us the benefit of either relatively low tax rates, tax holidays or government grants, in each case, that are dependent on how we operate or how many jobs we create and employees we retain. We plan on utilizing such tax incentives in the future as opportunities are made available to us. Any failure on our part to operate in conformity with applicable requirements to remain qualified for any such tax incentives or grants may result in an increase in our taxes. In addition, jurisdictions may choose to increase rates at any time due to economic or other factors, such as the current economic situation in Ireland. Any such rate increases may harm our results of operations.

In addition, we may lose sales or incur significant costs should various tax jurisdictions impose taxes on either a broader range of services or services that we have performed in the past. We may be subject to audits of the taxing authorities in the jurisdictions where we do business that would require us to incur costs in responding to such audits. Imposition of such taxes on our services could result in substantial unplanned costs, would effectively increase the cost of such services to our customers and may adversely affect our ability to retain existing customers or to gain new customers in the areas in which such taxes are imposed.

As we acquire companies or technologies, they could prove difficult to integrate, disrupt our business, dilute stockholder value and adversely affect our operating results and the value of our common stock.

As part of our business strategy, we may acquire, enter into joint ventures with, or make investments in companies, services and technologies that we believe to be complementary. Acquisitions and investments involve numerous risks, including:

- difficulties in identifying and acquiring technologies or businesses that will help our business;
- difficulties in integrating operations, technologies, services and personnel;
- diversion of financial and managerial resources from existing operations;
- the risk of entering new markets in which we have little to no experience;
- risks related to the assumption of known and unknown liabilities;
- potential litigation by third parties, such as claims related to intellectual property or other assets acquired or liabilities assumed;

- the risk of write-offs of goodwill and other intangible assets;
- delays in customer engagements due to uncertainty and the inability to maintain relationships with customers of the acquired businesses;
- inability to generate sufficient revenue to offset acquisition or investment costs;
- incurrence of acquisition-related costs;
- harm to our existing business relationships with business partners and customers as a result of the acquisition;
- the key personnel of the acquired entity or business may decide not to work for us or may not perform according to

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our expectations; and

- use of substantial portions of our available cash or dilutive issuances of equity securities or the incurrence of debt to consummate the acquisition.

As a result, if we fail to properly evaluate acquisitions or investments, we may not achieve the anticipated benefits of any such acquisitions, we may incur costs in excess of what we anticipate and management resources and attention may be diverted from other necessary or valuable activities.

We may be exposed to various risks related to legal proceedings or claims that could adversely affect our operating results.

From time to time, we may be party to lawsuits in the normal course of its business. Litigation in general can be expensive, lengthy and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict. Responding to lawsuits brought against us, or legal actions initiated by us, can often be expensive and time-consuming. Unfavorable outcomes from any claims and/or lawsuits could adversely affect our business, results of operations, or financial condition, and we could incur substantial monetary liability and/or be required to change its business practices. Our business and technology acquisition activity could also result in litigation in connection with such acquired companies. For example, refer to Item 3 of this Annual Report on Form 10-K which discusses some ongoing litigation related to our acquisition of Scout Analytics.

### Risks Relating to Owning Our Common Stock and Capitalization Matters

Our share price has been volatile and is likely to be volatile in the future.

The trading price of our common stock is likely to be highly volatile and could be subject to wide fluctuations in response to various factors. Further, our common stock has a limited trading history. In addition to the risks described in this section, factors that may cause the market price of our common stock to fluctuate include:

- fluctuations in our quarterly financial results or the quarterly financial results of companies perceived to be similar to us as discussed in more detail elsewhere in these “Risk Factors;”
- failure to achieve our revenue or earnings expectations, or those of investors or analysts;
- changes in estimates of our financial results or recommendations by securities analysts;
- recruitment or departure of key personnel;
- investors’ general perception of us;
- volatility inherent in prices of technology company stocks;
- adverse publicity;
- the volume of trading in our common stock, including sales upon exercise of outstanding options;
- sales of shares of our common stock by existing stockholders;

- regulatory developments in our target markets affecting us, our customers or our competitors;
- terrorist attacks or natural disasters or other such events impacting countries where we or our customers have operations; and
- actual or perceived changes in general economic, industry and market conditions.

In addition, if the stock market in general experiences a loss of investor confidence, the trading price of our common stock could decline for reasons unrelated to our business, financial condition or results of operations.

Some companies that have had volatile market prices for their securities have had securities class actions filed against them. If a suit were filed against us, regardless of its merits or outcome, it would likely result in substantial costs and divert

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management's attention and resources. This could have a material adverse effect on our business, operating results and financial condition.

Our actual results may differ significantly from any guidance that we may issue in the future.

From time to time, we may release financial guidance or other forward-looking statements in our earnings releases, earnings conference calls or otherwise, regarding our future performance that represent our management's estimates as of the date of release. If given, this guidance will be based on forecasts prepared by our management. These forecasts are not prepared with a view toward compliance with published accounting guidelines, and neither our independent registered public accounting firm nor any other independent expert or outside party compiles or examines the forecasts and, accordingly, no such person expresses any opinion or any other form of assurance with respect to such forecasts. The principal reason that we may release guidance is to provide a basis for our management to discuss our business outlook with analysts and investors. We do not accept any responsibility for any projections or reports published by any such third persons. Guidance is necessarily speculative in nature, and it can be expected that some or all of the assumptions of any future guidance furnished by us may not materialize or may vary significantly from actual future results.

Concentration of ownership among our existing executive officers, directors and their affiliates may prevent new investors from influencing significant corporate decisions.

Our directors and executive officers and their affiliates beneficially own, in the aggregate, over 10% of our outstanding common stock as of December 31, 2013. As a result, these stockholders will have substantial influence over all matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, such as a merger or other sale of our company or its assets. This concentration of ownership could limit the ability of other stockholders to influence corporate matters and may have the effect of delaying or preventing a third party from acquiring control over us.

Anti-takeover provisions contained in our certificate of incorporation and bylaws, as well as provisions of Delaware law, could impair a takeover attempt.

Our certificate of incorporation, by laws and Delaware law contain provisions that could have the effect of rendering more difficult or discouraging an acquisition deemed undesirable by our board of directors. Our corporate governance documents include provisions:

- authorizing blank check preferred stock, which could be issued by our board of directors without stockholder approval, with voting, liquidation, dividend and other rights superior to our common stock;
- classifying our board of directors, staggered into three classes, only one of which is elected at each annual meeting;
- limiting the liability of, and providing indemnification to, our directors and officers;
- limiting the ability of our stockholders to call and bring business before special meetings and to take action by written consent in lieu of a meeting;
- requiring advance notice of stockholder proposals for business to be conducted at meetings of our stockholders and for nominations of candidates for election to our board of directors;



- controlling the procedures for the conduct and scheduling of stockholder meetings;
- providing the board of directors with the express power to postpone previously scheduled annual meetings and to cancel previously scheduled special meetings;
- limiting the determination of the number of directors on our board and the filling of vacancies or newly created seats on the board to our board of directors then in office; and
- providing that directors may be removed by stockholders only for cause.

These provisions, alone or together, could delay hostile takeovers and changes in control or changes in our management.

As a Delaware corporation, we are also subject to provisions of Delaware law, including Section 203 of the Delaware General Corporation law, which limits the ability of stockholders owning in excess of 15% of our outstanding common stock to merge or combine with us.

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Any provision of our certificate of incorporation, by laws or Delaware law that has the effect of delaying or deterring a change in control could limit the opportunity for our stockholders to receive a premium for their shares of our common stock, and could also affect the price that some investors are willing to pay for our common stock

If securities or industry analysts do not publish or cease publishing research or reports about us, our business or our market, or if they change their recommendations regarding our stock, our stock price and trading volume could decline.

The trading market for our common stock will depend in part on the research and reports that securities or industry analysts publish about us or our business. If any of these analysts cease coverage of us, the trading price and trading volume of our stock could be negatively impacted. If analysts downgrade our stock or publish unfavorable research about our business, our stock price would also likely decline.

We are leveraged financially, which could adversely affect our ability to adjust our business to respond to competitive pressures and to obtain sufficient funds to satisfy our future growth, business needs and development plans.

We have substantial indebtedness. In August 2013, we issued \$150.0 million aggregate principal amount of convertible notes. The degree to which we are leveraged could have negative consequences, including, but not limited to, the following:

- we may be more vulnerable to economic downturns, less able to withstand competitive pressures and less flexible in responding to changing business and economic conditions;
- our ability to obtain additional financing in the future for working capital, capital expenditures, acquisitions, general corporate or other purposes may be limited;
- a substantial portion of our cash flows from operations in the future may be required for the payment of the principal amount of our existing indebtedness when it becomes due; and
- we may be required to make cash payments upon any conversion of the convertible notes, which would reduce our cash on hand.

A failure to comply with the covenants and other provisions of our debt instruments could result in events of default under such instruments, which could permit acceleration of all of our outstanding convertible notes and credit facilities. Any required repurchase of the convertible notes as a result of a fundamental change or acceleration of the convertible notes would reduce our cash on hand such that we would not have those funds available for use in our business. If we are at any time unable to generate sufficient cash flows from operations to service our indebtedness when payment is due, we may be required to attempt to renegotiate the terms of the instruments relating to the indebtedness, seek to refinance all or a portion of the indebtedness or obtain additional financing. There can be no assurance that we will be able to successfully renegotiate such terms, that any such refinancing would be possible or that any additional financing could be obtained on terms that are favorable or acceptable to us.

Conversion of our convertible notes will dilute the ownership interest of existing stockholders and may depress the price of our common stock.

The conversion of some or all of our convertible notes will dilute the ownership interests of then-existing stockholders to the extent we deliver shares upon conversion of any of the notes. Any sales in the public market of the common stock issuable upon such conversion could adversely affect prevailing market prices of our common stock. In addition, the existence of the notes may encourage short selling by market participants because the conversion of the notes could be used to satisfy short positions, or anticipated conversion of the notes into shares of our common stock could depress the price of our common stock.

The conditional conversion feature of the notes, if triggered, may adversely affect our financial condition and operating results.

In the event the conditional conversion feature of the notes is triggered, holders of notes will be entitled to convert the notes at any time during specified periods at their option. If one or more holders elect to convert their notes, unless we elect to satisfy our conversion obligation by delivering solely shares of our common stock (other than paying cash in lieu of delivering

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any fractional share), we would be required to settle a portion of our conversion obligation through the payment of cash, which could adversely affect our liquidity. In addition, even if holders do not elect to convert their notes, we could be required under

applicable accounting rules to reclassify all or a portion of the outstanding principal of the notes as a current rather than long-term liability, which would result in a material reduction of our net working capital.

The accounting method for convertible debt securities that may be settled in cash, such as the convertible notes, may have a material effect on our reported financial results.

In May 2008, the Financial Accounting Standards Board, which we refer to as FASB, issued FASB Staff Position No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement), which has subsequently been codified as Accounting Standards Codification 470-20, Debt with Conversion and Other Options, which we refer to as ASC 470-20. Under ASC 470-20, an entity must separately account for the liability and equity components of the convertible debt instruments (such as the notes) that may be settled entirely or partially in cash upon conversion in a manner that reflects the issuer's economic interest cost. The effect of ASC 470-20 on the accounting for the notes is that the equity component is required to be included in the additional paid-in capital section of stockholders' equity on our consolidated balance sheet, and the value of the equity component would be treated as original issue discount for purposes of accounting for the debt component of the notes. As a result, we will be required to record a greater amount of non-cash interest expense in current periods presented as a result of the amortization of the discounted carrying value of the notes to their face amount over the term of the notes. We will report lower net income (or greater net loss) in our financial results because ASC 470-20 will require interest to include both the current period's amortization of the debt discount and the instrument's coupon interest, which could adversely affect our reported or future financial results, the market price of our common stock and the trading price of the notes. In addition, convertible debt instruments (such as the notes) that may be settled entirely or partly in cash are currently accounted for utilizing the treasury stock method, the effect of which is that the shares issuable upon conversion of the notes are not included in the calculation of diluted earnings per share except to the extent that the conversion value of the notes exceeds their principal amount. Under the treasury stock method, for diluted earnings per share purposes, the transaction is accounted for as if the number of shares of common stock that would be necessary to settle such excess, if we elected to settle such excess in shares, are issued. We cannot be sure that the accounting standards in the future will continue to permit the use of the treasury stock method. If we are unable to use the treasury stock method in accounting for the shares issuable upon conversion of the notes, then our diluted earnings per share would be adversely affected.

ITEM 2.

PROPERTIES

Our corporate headquarters and principal administrative, sales and marketing and product development operations are located in San Francisco, California. We also have six globally distributed sales centers. We have two sales centers in North America located in Denver and Nashville. We have additional international sales centers in Dublin, Ireland; Liverpool, United Kingdom; Singapore and Tokyo, Japan. We also have a global sales operations center in Kuala Lumpur, Malaysia. We use this center to centralize key contract renewal processes that do not require regional expertise, such as customer data management and quoting. We do not own any real estate. All of our office space is leased under long-term leases with varying expiration dates. We believe that our facilities are adequate to meet our needs in the near future.

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Location	Square Footage Leased	Region	Principal Use
San Francisco	45,361	NALA	Headquarters
Denver	71,319	NALA	Sales Center
Nashville	108,768	NALA	Sales Center
Singapore	26,154	APJ	International Sales Center
Kuala Lumpur	70,782	APJ	Sales Operation Center
Japan	1,173	APJ	International Sales Center
Dublin	38,060	EMEA	International Sales Center
Liverpool	25,500	EMEA	International Sales Center

## ITEM 3. LEGAL PROCEEDINGS

Bionet Systems, LLC, et al. v. Scout Analytics, Inc., et al., in Superior Court, King County, Washington State  
On January 10, 2014, certain now-former holders of Scout Analytics, Inc. (“Scout”) capital stock filed a lawsuit against Scout and some of its directors and their employers regarding the then-pending acquisition of Scout by us. The plaintiffs have asserted claims against all defendants for breach of fiduciary duty, minority shareholder oppression, corporate waste, injunctive relief and unjust enrichment. In their complaint, the plaintiffs seek damages and payment of their attorneys’ fees and costs.

The costs of such litigation are expected to be covered by Scout’s insurance and/or from the escrow amounts held back from the merger consideration paid for Scout and the other indemnification obligations of the former Scout holders of capital stock.

From time to time, we may be subject to other litigation or threatened litigation in the general nature of business. We do not believe the resolution of the Scout litigation or any other matters will have a material adverse impact on our consolidated financial position, results of operations or cash flows.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

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## PART II

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

## Market Information

Our common stock is traded on The NASDAQ Global Market under the symbol "SREV" since it began trading on March 25, 2011. Our initial public offering was priced at \$10.00 per share on March 24, 2011. The following table sets forth, for the time period indicated, the high and low prices of our common stock as reported on The NASDAQ Global Market.

	2013	
	High	Low
First Quarter	\$7.31	\$5.63
Second Quarter	\$9.46	\$5.33
Third Quarter	\$13.69	\$9.32
Fourth Quarter	\$12.99	\$7.77
	2012	
	High	Low
First Quarter	\$18.00	\$14.38
Second Quarter	\$16.78	\$11.28
Third Quarter	\$13.99	\$7.73
Fourth Quarter	\$10.77	\$4.01

## Holders

As of February 28, 2014, there were 92 holders of record of our common stock. A substantially greater number of holders of our common stock are "street name" or beneficial holders, whose shares are held by banks, brokers and other financial institutions.

## Dividends

We have never declared or paid cash dividends on our common stock. We currently intend to retain all available funds and any future earnings for use in the operation of our business and do not anticipate paying any dividends on our common stock in the foreseeable future. Any future determination to declare dividends will be made at the discretion of our board of directors and will depend on our financial condition, operating results, capital requirements, general business conditions and other factors that our board of directors may deem relevant. In addition, our credit facility contains certain restrictions on our ability to declare and pay cash dividends on our capital stock.

## Stock Performance Graph

This performance graph shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), or incorporated by reference into any filing of ServiceSource under the Securities Act of 1933, as amended, or the Exchange Act, except as shall be expressly set forth by specific reference in such filing. The following graph shows a comparison from March 25, 2011 (the date our common stock commenced trading on The NASDAQ Global Market) through December 31, 2013, of the cumulative total return for (1) our common stock, (2) the Morgan Stanley Technology Index, and (3) the NASDAQ Composite Index. Such returns are based on historical results and are not intended to suggest future performance. Data for the NASDAQ Composite Index and the Morgan Stanley Technology Index assume reinvestment of dividends. We have never declared or paid cash dividends on our common stock nor do we anticipate paying any such cash dividends in the foreseeable future.

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	ServiceSource	Morgan Stanley Technology Index	NASDAQ Composite Index
3/25/2011	100.00	100.00	100.00
6/30/2011	182.43	96.60	99.73
9/30/2011	108.46	81.85	86.85
12/30/2011	128.82	86.49	93.67
3/30/2012	127.09	105.28	111.16
6/29/2012	113.71	94.60	105.54
9/28/2012	84.36	100.52	112.05
12/31/2012	48.03	100.73	108.57
3/28/2013	58.05	108.26	117.49
6/28/2013	76.52	109.46	122.37
9/30/2013	99.18	120.59	135.61
12/31/2013	68.80	132.75	150.18

## Recent Sales of Unregistered Securities

None.

## Purchases of Equity Securities by the Issuer and Affiliated Purchasers

We did not repurchase any shares of our common stock in the year ending December 31, 2013.

We launched in December 2012 and completed in January 2013 a stock option exchange program pursuant to which eligible employees were able to exchange certain outstanding out-of-the money stock options with an exercise price greater than \$6.03 per share for a lesser amount of new stock options. See Note 11 to the of the Notes to Consolidated Financial Statements for a description of this stock option exchange program.

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## ITEM 6. SELECTED FINANCIAL DATA

The following selected consolidated financial data should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our consolidated financial statements and the related notes included elsewhere in this Annual Report on Form 10-K.

	Years Ended December 31,				
	2013	2012	2011	2010	2009
	(in thousands, except per share amounts)				
Net revenue	\$272,482	243,703	205,501	152,935	110,676
Cost of revenue <sup>(1)</sup>	162,449	136,321	113,406	90,048	58,877
Gross profit	110,033	107,382	92,095	62,887	51,799
Operating expenses:					
Sales and marketing <sup>(1)</sup>	58,826	56,925	48,520	35,119	23,182
Research and development <sup>(1)</sup>	23,855	19,255	13,073	7,188	2,054
General and administrative <sup>(1)</sup>	44,913	41,135	33,647	19,378	13,845
Total operating expenses	127,594	117,315	95,240	61,685	39,081
Income (loss) from operations	(17,561)	) (9,933)	) (3,145)	) 1,202	) 12,718
Other income (expense):					
Interest expense	(3,754)	) (236)	) (503)	) (1,271)	) (1,116)
Other, net	(666)	) (538)	) (624)	) (351)	) 639
Income (loss) before income taxes	(21,981)	) (10,707)	) (4,272)	) (420)	) 12,241
Income tax provision (benefit)	871	) 32,107	) (19,383)	) 2,147	) 1,866
Net income (loss)	\$(22,852)	) \$(42,814)	) \$15,111	) \$(2,567)	) \$10,375
Net income (loss) per common share:					
Basic	\$(0.29)	) \$(0.58)	) \$0.23	) \$(0.04)	) \$0.18
Diluted	\$(0.29)	) \$(0.58)	) \$0.21	) \$(0.04)	) \$0.18
Cash distribution per common share <sup>(2)</sup>	\$—	) \$—	) \$—	) \$0.04	) \$—
Weighted-average shares used in computing net income (loss) per common share:					
Basic	78,408	74,270	66,656	57,284	56,750
Diluted	78,408	74,270	73,585	57,284	58,912

(1) Reported amounts include stock-based compensation expense as follows:

	Years Ended December 31,				
	2013	2012	2011	2010	2009
	(in thousands)				
Cost of revenue	\$3,303	\$2,772	\$1,877	\$1,126	\$914
Sales and marketing	9,831	8,146	4,456	2,993	2,340
Research and development	2,414	1,880	1,167	803	541
General and administrative	8,072	8,077	4,099	3,167	2,265
Total stock-based compensation	\$23,620	\$20,875	\$11,599	\$8,089	\$6,060

(2) Pursuant to our previous limited liability company agreement, we were required to pay cash distributions to our members to fund their tax obligations in respect of their equity interests. All other distributions are determined by our directors in their sole discretion. Tax distributions to members were \$0, \$0, \$0, \$2.5 million and \$0 in 2013, 2012, 2011, 2010 and 2009 respectively. Effective with our initial public offering, we converted from a limited



liability company into a Delaware corporation.

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	As of December 31,				
	2013	2012	2011	2010	2009
	(in thousands)				
Consolidated Balance Sheet Data:					
Cash, cash equivalents and short-term investments	\$275,133	\$109,442	\$108,865	\$22,652	\$13,169
Working capital	315,185	149,431	134,796	18,135	19,099
Total assets	399,946	224,472	238,961	108,103	69,580
Term loan, current and non-current	—	—	—	15,459	16,835
Obligations under capital leases, current and non-current	657	964	1,664	1,759	773
Convertible notes, net	113,915	—	—	—	—
Total members'/stockholders' equity	240,697	186,927	197,016	33,884	30,331

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with our annual consolidated financial statements and notes thereto which appear elsewhere in this Annual Report on Form 10-K.

This discussion contains "forward-looking statements" that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. These statements are based on the beliefs and assumptions of our management based on information currently available to management. Such forward-looking statements are subject to risks, uncertainties and other important factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section of this Annual Report on Form 10-K titled "Special Note Regarding Forward Looking Statements and Industry Data" and "Risk Factors". Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

Overview

We are the global leader in recurring revenue management. We offer a cloud application, Renew OnDemand, to automate this highly valuable but typically manual business process. Renew OnDemand and our proven managed services, drive higher subscription, maintenance and support revenue while improving customer retention and increasing business predictability.

We manage the service contract renewals process for renewals of maintenance, support and subscription agreements on behalf of our customers. Our integrated solution consists of dedicated service sales teams working under our customers' brands and our proprietary Renew OnDemand platform and applications. By integrating software, managed services and data, we address the critical steps of the renewals process including data management, quoting, selling and recurring revenue business intelligence. Our business is built on our pay-for-performance model, whereby our revenues are based on the service renewals customers achieve with our solution, although we have been establishing a base of subscription revenue agreements to our technology platform and applications.

We are currently in a period of significant investment in which we have taken steps designed to drive our future growth and profitability. These investments have included growth in our professional services teams, hiring engineers in product management and R&D to develop and expand our product footprint, and sustaining our investments in sales and marketing to reposition us and enhance our market presence. We plan to further build out our infrastructure, develop our technology and support Renew OnDemand, our next-generation technology platform, offer additional cloud-based applications, including on a stand-alone, subscription basis, and hire additional sales, service sales and other personnel. These steps impacted our expenses in recent periods as well as our spending for capital expenditures, and are expected to continue to impact our profitability and cash flows in future periods. We have devoted significant resources to developing Renew OnDemand, our software application suite, and we expect our investment in Renew OnDemand to continue. In addition, we plan to devote significant resources to expanding our sales organization, building out the related partner ecosystem, and further developing our service organization to support the platform. On the sales side, we have seen early success with some of the new sales incentives around Renew OnDemand subscriptions, which drives short-term expense, but has improved our time to market this new solution. The capital expenditures and expenses related to Renew OnDemand are in addition to the expenses of operating our existing technology platform. While these expenses will be incurred and recognized in the near-term, we expect to generate revenues from the sale of subscriptions to Renew OnDemand that will increase over time in 2014.

### 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 recurring revenue opportunity under management and number of engagements.

**Recurring Revenue Opportunity Under Management.** At December 31, 2013, we estimated our opportunity under management to be over \$11.6 billion. Recurring revenue opportunity under management (“opportunity under management”) is a forward-looking metric and is our estimate, as of a given date, of the value of all end customer service contracts that we will have the opportunity to sell or provide support on behalf of our customers over the subsequent twelve-month period. Opportunity under management is not a measure of our expected revenue. In addition, opportunity under management reflects

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our estimate for a forward twelve-month period and should not be used to estimate our opportunity for any particular quarter within that period. The value of end customer contracts actually delivered during a twelve-month period should not be expected to occur in even quarterly increments due to seasonality and other factors impacting our customers 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 customers in past periods, the minimum value of end customer contracts that our customers are required to give us the opportunity to sell pursuant to the terms of their contracts with us, periodic internal business reviews of our expectations as to the value of end customer contracts that will be made available to us by customers, the value of end customer contracts included in the SPA and collaborative discussions with our customers assessing their expectations as to the value of service contracts that they will make available to us for sale. While the minimum value of end customer contracts that our customers 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 customers 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 recurring revenue 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 twelve-month period to differ from our estimate of opportunity under management. These factors include:

- the extent to which customers deliver a greater or lesser value of end customer contracts than may be required or otherwise expected;
- roll-overs of unsold service contract renewals from prior periods to the current period or future periods;
- changes in the pricing or terms of service contracts offered by our customers;
- increases or decreases in the end customer base of our customers;
- the extent to which the renewal rates we achieve on behalf of a customer early in an engagement affect the amount of opportunity that the customer makes available to us later in the engagement;
- customer cancellations of their contracts with us; and
- changes in our customers' businesses, sales organizations, management, sales processes or priorities.

Our revenue also depends on our close rates and commissions. Our close rate is the percentage of opportunity under management that we renew on behalf of our customers. Our commission rate is an agreed-upon percentage of the renewal value of end customer contracts that we sell on behalf of our customers.

Our close rate is impacted principally by our ability to successfully sell service contracts on behalf of our customers. Other factors impacting our close rate include: the manner in which our customers 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 customers 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 close rates, as described above, are evaluated. These factors include: historical, industry-specific and customer-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.

**Number of Engagements.** We track the number of engagements we have with our customers. We often have multiple engagements with a single customer, 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 customer is associated with a separate customer 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 to us 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 customer in the United States and another

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engagement consisting of a sales team selling warranty contract renewals of a different product for the same customer in Europe. These would count as two engagements. We had approximately 150, 145 and 120 engagements as of December 31, 2013, 2012 and 2011 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 customers and educate them about our offerings. Educating prospective customers about the benefits of our solution can take time, as many of these prospects have not historically relied upon integrated solutions like ours for recurring 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 a SPA of our prospect's recurring revenue. The SPA includes an analysis of best practices and benchmarks the prospect's recurring 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 recurring revenue, identify potential areas of performance improvement, and formulate our proposal for managing the prospect's recurring revenue. The length of our sales cycle for a new customer, inclusive of the SPA process and measured from our first formal discussion with the customer until execution of a new customer contract, is typically longer than six months and has increased in recent periods.

We generally contract with new customers to manage a specified portion of their recurring 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 customer contracts, including commission rates, based on the output of the SPA, including the areas identified for improvement. Once we demonstrate success to a customer 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.

**Implementation Cycle.** After entering into an engagement with a new customer, and to a lesser extent after adding an engagement with an existing customer, we incur sales and marketing expenses related to the commissions owed to our sales personnel. The commissions are based on the estimated total contract value, with a material portion of the commission expensed upfront with 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 customers, and, to a lesser extent, an increase in engagements with existing customers, or a significant increase in the contract value associated with such new customers 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 customers.

Although we expect new customer engagements to contribute to our operating profitability over time, in the initial periods of a customer 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 customer. As a result, an increase in the mix of new customers as a percentage of total customers may initially have a negative impact on our operating results. Similarly, a decline in the ratio of new customers to total customers may positively impact our near-term operating results.

**Contract Terms.** Substantially all 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 customers. In some cases, we earn additional performance-based commissions for exceeding pre-determined service

renewal targets.

Our new customer contracts have typically had a term of approximately 36 months, although we sometimes have contract terms of up to 60 months. Our contracts generally require our customers to deliver a minimum value of qualifying recurring 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 customer contracts are cancelable on relatively short notice, subject in most cases to the payment of an early termination fee by the customer. The amount of this fee is based on the length of the remaining term and value of the contract.

We invoice our customers 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. Amounts invoiced to our customers are recognized as revenue in the period in which our services are performed or, in the case of performance commissions, when the performance condition is determinable. Because the invoicing for our services generally



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coincides with or immediately follows the sale of service contracts on behalf of our customers, we do not generate or report a significant deferred revenue balance. However, the combination of minimum contractual commitments, our success in generating improved renewal rates for our customers, our customers' historical renewal rates and the performance improvement potential identified by our SPA process, provides us with revenue visibility.

**M&A Activity.** Our customers, 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 customers 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 customer 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. For example, Oracle terminated our contracts with Sun Microsystems in 2010 and had previously terminated our contract with another customer, BEA Systems, in 2008.

**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 the recent economic downturn led 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 customers, 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.

We believe the current uncertainty in the economy, combined with shifting market forces toward subscription-based models, is impacting a number of our customers and prospective customers, 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 next couple years, we would expect this pattern to continue.

**Adoption of "Software-as-a-Service" Solutions.** Within the software industry, there is a growing trend toward providing software to customers using a software-as-a-service ("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. SaaS companies face a distinct set of challenges with respect to customer renewals, given the potentially lower switching costs for customers utilizing their solutions, and are more reliant on renewals for their long-term revenues than traditional software companies. Given the strategic importance of renewals to their model, SaaS companies may be less inclined than traditional software companies to rely on third-party solutions such as ours to manage the sale of renewals of subscription contracts. We have tailored our solution to address the needs of SaaS companies in this area and expect to continue to develop and enhance our solution as this market grows, especially with our Renew OnDemand application suite.

In connection with our purpose-built SaaS offering to manage and maximize recurring revenue, we intend to significantly increase our investment in our customer support, training and professional services organizations to support deployments of Renew OnDemand. We anticipate that the cost of providing professional services, support and training will be significant and that our gross profit will be adversely affected as we build out these functions.

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### 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 customers. We generally invoice our customers 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 customers and their end customers.

We also earn revenue from the sale of subscriptions to our cloud based applications. To date, subscription revenue has been insignificant. However, we expect revenues generated from subscriptions to Renew OnDemand to increase in 2014. Subscription fees are billed on either a monthly or quarterly basis in advance and revenue is recognized ratably over the related subscription term.

We have generated a significant portion of our total net revenue from a limited number of customers. For the years ended December 31, 2013, 2012, and 2011, our top ten customers in each period accounted for 50%, 50%, and 47% of our net revenue, respectively. One customer accounted for more than 10% of our revenues in 2013, 2012 and 2011. Our business is geographically diversified. During 2013, 64% of our net revenue was earned in North America and Latin America (“NALA”), 27% in Europe, Middle East and Africa (“EMEA”) and 9% 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. Our APJ segment is our most recent segment, and as a result accounts for less of our net revenue. In addition, our Kuala Lumpur location is also our global sales operations center where we have centralized, for our worldwide operations, the key contract renewal processes that do not require regional expertise, such as customer data management and quoting. We do not generate any customer revenue out of Kuala Lumpur, so it is effectively a cost center which contributes to our APJ segment.

#### Cost of Revenue and Gross Profit

Our cost of revenue expenses include compensation, technology costs, including those related to the delivery of our cloud-based solutions, and allocated overhead costs. Compensation 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 recurring 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. We currently expect that our cost of revenue will fluctuate significantly and may increase on an absolute basis and as a percentage of revenue in the near term, including for the reasons discussed above under, “—Factors Affecting Our Performance—Implementation Cycle” and as a result of our near term plans to run dual technology platforms for several quarters as we commence the launch of Renew OnDemand while maintaining our existing technology platform.

#### Operating Expenses

**Sales and Marketing.** Sales and marketing expenses are the largest component of our operating expenses and consist primarily of compensation 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 twelve and fourteen months following the execution of the applicable contract. We currently expect sales and marketing expenses to increase on an absolute basis and as a percentage of revenue in the near term based on

commissions earned on customer contracts entered into in prior periods, as well as continued investments in sales and marketing personnel and programs as we expand our business domestically and internationally and pursue new sales initiatives.

Research and Development. Research and development expenses consist primarily of compensation, allocated costs and the cost of third-party service providers. We focus our research and development efforts on developing new products, including Renew OnDemand, our next-generation technology platform, and adding new features to our existing technology platform. In

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connection with the development and enhancements of our SaaS 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 increase on an absolute basis and as a percentage of revenue in the near term as we continue to invest in our Renew OnDemand platform.

**General and Administrative.** General and administrative expenses consist primarily of compensation for our executives, 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 on an absolute basis to support our anticipated growth.

**Other Income (Expense), Net**

**Interest expense.** Interest expense consists primarily of interest expense associated with fees related to our credit facility, our convertible debt; 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 significantly from accretion of debt discount, amortization of deferred financing costs and contractual interest costs as a result of our August 2013 issuance of \$150 million aggregate principal amount of convertible notes.

**Other, Net.** Other, net consists primarily of the interest income earned on our cash, cash equivalents and marketable securities investments and foreign exchange gains and losses. We expect other, net 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.

**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 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 the need for and amount of any valuation allowance for our 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. In concluding on our evaluation, we place significant emphasis on guidance 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.

For a description of our accounting practices relating to income taxes, see "-Critical Accounting Policies and Estimates-Income Taxes" below.

Results of Operations

The table below sets forth our consolidated results of operations for the periods presented. The period-to-period comparison of financial results presented below is not necessarily indicative of financial results to be achieved in future periods.

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	Years Ended December 31,			
	2013	2012	2011	
Consolidated statement of operations data:	(in thousands)			
Net revenue	\$272,482	\$243,703	\$205,501	
Cost of revenue	162,449	136,321	113,406	
Gross profit	110,033	107,382	92,095	
Operating expenses:				
Sales and marketing	58,826	56,925	48,520	
Research and development	23,855	19,255	13,073	
General and administrative	44,913	41,135	33,647	
Total operating expenses	127,594	117,315	95,240	
Loss from operations	(17,561	) (9,933	) (3,145	)
Other income (expense):				
Interest expense	(3,754	) (236	) (503	)
Other, net	(666	) (538	) (624	)
Loss before income taxes	(21,981	) (10,707	) (4,272	)
Income tax provision (benefit)	871	32,107	(19,383	)
Net income (loss)	\$(22,852	) \$(42,814	) \$15,111	
Includes stock-based compensation of:				
Cost of revenue	\$3,303	\$2,772	\$1,877	
Sales and marketing	9,831	8,146	4,456	
Research and development	2,414	1,880	1,167	
General and administrative	8,072	8,077	4,099	
Total stock-based compensation	\$23,620	\$20,875	\$11,599	

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

	Years Ended December 31,			
	2013	2012	2011	
	(as % of net revenue)			
Net revenue	100	% 100	% 100	%
Cost of revenue	60	% 56	% 55	%
Gross profit	40	% 44	% 45	%
Operating expenses:				
Sales and marketing	22	% 23	% 24	%
Research and development	9	% 8	% 6	%
General and administrative	16	% 17	% 16	%
Total operating expenses	47	% 48	% 46	%
Loss from operations	(7	)% (4	)% (1	)%
Years Ended—December 31, 2013 and 2012				
Net Revenue				

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	Years Ended December 31, 2013		2012		Change	% Change
	Amount (in thousand)	% of Net Revenue	Amount	% of Net Revenue		
Net revenue						
NALA	\$ 173,188	64	% \$ 150,041	62	% \$ 23,147	15
EMEA	73,839	27	% 66,902	27	% 6,937	10
APJ	25,455	9	% 26,760	11	% (1,305 )	(5 )%
Total net revenue	\$ 272,482	100	% \$ 243,703	100	% \$ 28,779	12

Net revenue increased \$28.8 million, or 12%, in 2013 compared to 2012. Our revenue performance was driven by a combination of growth in opportunity from new and existing customers, as well as strong performance across our NALA and EMEA service sales centers in closing recurring revenue renewals. The increase in net revenue reflects revenue growth in NALA and EMEA, due to an increase in the number and value of service contracts sold on behalf of our customers and the ramp of new engagements entered into in 2012 and first half of 2013. These increases were partially offset in all regions due to customer attrition.

## Cost of Revenue and Gross Profit

	Years Ended December 31,		Change	% Change
	2013	2012		
	(in thousands)			
Cost of revenue	\$ 162,449	\$ 136,321	\$ 26,128	19
Included stock-based compensation of:	3,303	2,772	531	19
Gross profit	110,033	107,382	2,651	2
Gross profit percentage	40	% 44	% (4	)%

The 19% increase in our cost of revenue in 2013 compared to 2012, reflected an increase in the number of service sales personnel, primarily in NALA and APJ, as we pursue new sales initiatives and professional services personnel associated with implementation of our Renew OnDemand application suite for our customers resulting in a \$17.6 million increase in compensation and a \$8.3 million increase in allocated costs for facilities, including incremental facility costs related to expansion of facilities in NALA and APJ, and greater allocations for information technology and depreciation, partially offset by decrease in travel expenses of \$1.8 million. Gross profit in 2013 was adversely impacted by the increased expenditures for professional services and our staff operations costs, as well as the shift in some of these expenses from research and development to cost of revenue, as we moved from the products being in development to having deployed customers on Renew OnDemand as well as slower ramp of some of our larger new engagements and due to staffing and technology costs associated with the deployment of our cloud applications. For the next several quarters, we expect that our spending will reflect increased amounts to support our legacy recurring revenue intelligence platform in addition to our Renew OnDemand application suite as well as increased spending on deployments of our cloud applications.

## Operating Expenses



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	Years Ended December 31,				Change	% Change
	2013	% of Net Revenue	2012	% of Net Revenue		
	Amount		Amount			
	(in thousand)					
Operating expenses:						
Sales and marketing	\$58,826	22	% \$56,925	23	% \$1,901	3
Research and development	23,855	9	% 19,255	8	% 4,600	24
General and administrative	44,913	16	% 41,135	17	% 3,778	9
Total operating expenses	\$127,594	47	% \$117,315	48	% \$10,279	9
Includes stock-based compensation of:						
Sales and marketing	\$9,831		\$8,146		\$1,685	
Research and development	2,414		1,880		534	
General and administrative	8,072		8,077		(5	)
Total stock-based compensation	\$20,317		\$18,103		\$2,214	

## Sales and marketing expenses

The 3% increase in sales and marketing expenses in 2013 reflected higher stock-based compensation and an increase in the number of sales and marketing personnel, primarily in NALA and EMEA resulting in a \$3.4 million increase in compensation. The increase in headcount reflected our investment in sales and marketing resources aimed at expanding our customer base. The increase was partially offset by lower marketing expenses of \$1.2 million as a result of lower spending on brand development initiatives and lower travel and entertainment expenses of \$0.7 million. We expect sales and marketing expenses to increase in 2014 as we sustain our investments in sales and marketing to reposition us and enhance our market presence.

## Research and development expenses

The 24% increase in research and development expense in 2013 was primarily due to the fact that no capitalization of labor and third party costs for development of internal-use software took place in the year compared to \$6.1 million capitalized costs in 2012, offset by lower expenses due to transition of configuration engineers from R&D to professional services as these individuals focus more on revenue generating activities. In 2012, we were capitalizing the development costs associated with Renew OnDemand which was released to customers in the fourth quarter of 2012. The research and development costs incurred in 2013 on Renew OnDemand have been focused supporting product functionality and robustness. We expect research and development spending to increase on an absolute basis and as a percentage of revenue in the near term as we continue to build out and grow our technology subscription business and hire engineers in product management and R&D to develop and expand our product footprint. We do not expect that future capitalization of internal-use software costs to be significant.

## General and administrative expenses

The 9% increase in general and administrative expense in 2013 compared to 2012 reflected a \$2.5 million increase in compensation due to hiring and investments in our IT infrastructure to support our global operations partially offset by lower allocations of information technology costs and depreciation.

We anticipate increased spending in 2014 for general and administrative functions to support the overall growth anticipated in our operations.

## Other Expense, Net

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	Years Ended December 31, 2013		2012		Change	% Change
	Amount	% of Net Revenue	Amount	% of Net Revenue		
	(in thousands)					
Interest expense	\$(3,754 )	(1 )%	\$(236 )	—	% \$(3,518 )	1,491 %
Other, net	\$(666 )	—	% \$(538 )	—	% \$(128 )	24 %

Interest expense for 2013 increased by \$3.5 million as compared to 2012 due to accretion of debt discount and the amortization of debt issuance costs of \$2.8 million and interest expense of \$0.9 million for the convertible notes issued in August 2013.

## Income Tax Provision

	Years Ended December 31, 2013		Change	% Change
	2012	(in thousands)		
Income tax provision	\$871	\$32,107	\$(31,236 )	(97 )%

In 2013, income tax expense of \$0.9 million was recorded. This amount primarily represents taxes in domestic and foreign jurisdictions where we have profitable operations, including certain U.S. states, offset by benefits from state tax credits. No benefit was provided for losses incurred in U.S. and Singapore, because these losses are offset by a full valuation allowance. In December 2013, our Malaysia subsidiary was granted a ten year tax holiday as an Operational Headquarters (OHQ), commencing January 1, 2014. The 2013 tax provision includes a benefit of \$0.2 million resulting from a revaluation of previously recorded Malaysia deferred tax liabilities as a result of the OHQ tax holiday.

During the second quarter of 2012, a valuation allowance against our U.S. deferred tax assets was recorded in the amount of \$31.8 million as the cumulative losses for the most recent three years, as well as the U.S. losses in the first half of 2012, represented significant negative evidence for us to conclude that a valuation allowance was required. Accordingly, the computation of the effective tax rate does not include U.S. losses, nor does it include losses incurred by our Singapore subsidiary, which are offset by a full valuation allowance. The 2012 tax provisions also reflects tax expense in jurisdictions where we report taxable profits.

Years Ended—December 31, 2012 and 2011

## Net Revenue

	Years Ended December 31, 2012		2011		Change	% Change
	Amount	% of Net Revenue	Amount	% of Net Revenue		
	(in thousand)					
Net revenue						
NALA	\$150,041	62 %	\$127,430	62 %	\$22,611	18 %
EMEA	66,902	27 %	58,344	28 %	8,558	15 %
APJ	26,760	11 %	19,727	10 %	7,033	36 %
Total net revenue	\$243,703	100 %	\$205,501	100 %	\$38,202	19 %

The 19% increase in net revenue in 2012 reflects an increase in the number of engagements from 120 at December 31, 2011 to over 145 at December 31, 2012 as well as an increase in the value of service contracts sold on behalf of our customers. Our revenue performance was driven by a combination of growth in opportunity from new and existing

customers, as well as strong performance across all of our service sales centers around the world in closing service revenue renewals. The increase in number of customer engagements resulted from expansion of customer engagements with certain existing customers due to the success of our solution with these customers as well as new customer acquisitions due to our investments in our sales organization. These increases were partially offset by a few customers in NALA and APJ where the scope of our services was

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reduced as well as the impact of customer terminations in EMEA in the last half of 2011. The increase in net revenue reflects revenue growth in all geographies, particularly NALA and APJ, due to an increase in the number and value of service contracts sold on behalf of our customers and the ramp of new engagements entered into in 2011.

## Cost of Revenue and Gross Profit

	Years Ended December 31,			% Change	
	2012	2011	Change		
	(in thousands)				
Cost of revenue	\$136,321	\$113,406	\$22,915	20	%
Included stock-based compensation of:	2,772	1,877	895	48	%
Gross profit	107,382	92,095	15,287	17	%
Gross profit percentage	44	% 45	% (1	)%	

The 20% increase in our cost of revenue in 2012 reflected an increase in the number of service sales and sales operational personnel, primarily in APJ, resulting in a \$16.6 million increase in compensation and temporary labor, a \$5.4 million increase in allocated costs for facilities, including incremental facility costs related to an expansion of an existing facility, and greater costs for information technology and depreciation. The decrease in our gross profit was driven primarily by the slower ramp of new customers added in the last half of 2011 and during 2012, technology costs associated with hosting our cloud applications and lower margins from professional service engagements associated with the deployment of our cloud applications. For the next several quarters, we expect that our spending will reflect increased amounts to support our legacy service revenue platform in addition to our Renew OnDemand application suite as well as increased spending on customer support and training to support future deployments of our cloud applications.

## Operating Expenses

	Years Ended December 31,						
	2012		2011		Change	% Change	
	Amount	% of Net Revenue	Amount	% of Net Revenue			
	(in thousand)						
Operating expenses:							
Sales and marketing	\$56,925	23	% \$48,520	24	% \$8,405	17	%
Research and development	19,255	8	% 13,073	6	% 6,182	47	%
General and administrative	41,135	17	% 33,647	16	% 7,488	22	%
Total operating expenses	\$117,315	48	% \$95,240	46	% \$22,075	23	%
Includes stock-based compensation of:							
Sales and marketing	\$8,146		\$4,456		\$3,690		
Research and development	1,880		1,167		713		
General and administrative	8,077		4,099		3,978		
Total stock-based compensation	\$18,103		\$9,722		\$8,381		
Sales and marketing expenses							

The 17% increase in sales and marketing expenses in 2012 reflected an increase in the number of sales and marketing personnel, primarily in NALA, resulting in a \$4.8 million increase in compensation. The increase also resulted from a \$1.7 million increase in marketing program expenses as a result of additional investments in brand development to heighten awareness and to maximize the strength of our brand and an increase in costs for facilities and IT of \$1.1 million associated with higher headcount.

## Research and development expenses



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The increase in research and development expense in 2012 reflected an increase in the number of research and development personnel in NALA, resulting in a \$1.8 million increase in compensation, a \$3.6 million increase in outside consulting services related to contract research and development services and a \$0.5 million increase in facilities and IT costs. The increase is a result of our continued investment in the development of additional cloud based applications to enable greater operational efficiencies and enhanced functionality for our customers. The increase was partially offset by capitalization of \$6.2 million of internal labor and third party costs for development of internal-use software in 2012 compared to \$6.0 million of capitalized costs in 2011. We expect research and development expenditures to increase in both absolute dollars and as a percentage of net revenues as we continue to enhance Renew OnDemand and our expectations that there will be an insignificant amount of capitalized costs in 2013.

## General and administrative expenses

The 23% increase in general and administrative expenses in 2012 reflected a \$7.5 million increase in compensation due to an increase in headcount in the general and administrative functions across all geographic segments. We anticipate increased spending for general and administrative functions to support the overall growth anticipated in our operations.

## Other Expense, Net

	Years Ended December 31, 2012		2011		Change	% Change
	Amount	% of Net Revenue	Amount	% of Net Revenue		
	(in thousands)					
Interest expense	\$(236 )	—	% \$(503 )	—	% \$267	(53 )%
Other, net	\$(538 )	—	% \$(624 )	—	% \$86	(14 )%

The decrease in other expense in 2012 compared to 2011 resulted from a \$0.4 million decrease in interest expense and the write-off of costs associated with our borrowings due to the repayment of outstanding balances on our term loan and borrowings under our revolving credit facility in March 2011, partially offset by a \$0.1 million increase in interest income in 2012 from our short-term investments.

## Income Tax Provision (Benefit)

	Years Ended December 31,		Change	% Change
	2012	2011		
	(in thousands)			
Income tax (benefit) provision	\$32,107	\$(19,383 )	\$51,490	*

\*Not meaningful.

During the second quarter of 2012, a valuation allowance against our U.S. deferred tax assets was recorded in the amount of \$31.8 million as the cumulative losses for the most recent three years, as well as the U.S. losses in the first half of 2012, represented significant negative evidence for us to conclude that a valuation allowance was required. Accordingly, the computation of the effective tax rate does not include U.S. losses, nor does it include losses incurred by our Singapore subsidiary, which are offset by a full valuation allowance. In 2011, we recorded a one-time non-cash tax benefit of \$20.7 million as a result of recognition of deferred tax assets resulting from our election to be subject to taxation as a corporation.

## Liquidity and Capital Resources

At December 31, 2013, we had cash, cash equivalents and short-term investments of \$275.1 million, which primarily consisted of cash, money market accounts, corporate bonds and U.S. government obligations held by well-capitalized financial institutions. In addition, at December 31, 2013, we had cash and cash equivalents of \$3.1 million held outside of the U.S. by our foreign subsidiaries that was generated by such subsidiaries and which is used to satisfy their current operating requirements. We consider the undistributed earnings of our foreign subsidiaries to be indefinitely reinvested in foreign operations and our current plans do not require us to repatriate these earnings to fund our U.S. operations as we have sufficient

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cash, cash-equivalents and short-term investments held in the U.S. and have access to external funding under our credit agreement.

Our primary operating cash requirements include the payment of compensation and related costs, working capital requirements related to accounts receivable and accounts payable, as well as costs for our facilities and information technology infrastructure. Historically, we have financed our operations principally from cash provided by our operating activities, proceeds from stock offerings and the exercise of stock options, and to a lesser extent, from borrowings under various credit facilities, with no such borrowings in 2013. We believe our existing cash and cash equivalents and short-term investments and our currently available credit facility will be sufficient to meet our working capital and capital expenditure needs for at least the next twelve months.

In August 2013, we issued \$150 million aggregate principal amount of 1.50% convertible notes due August 1, 2018 (the "Notes") and concurrently entered into convertible notes hedges and separate warrant transactions. The Notes will mature on August 1, 2018, unless earlier converted. Upon conversion, the Notes will be settled in cash, shares of our stock, or any combination thereof, at our option. We received proceeds of \$145.1 million from the issuance of the convertible notes, net of associated fees, received \$21.8 million from the issuance of the warrants and paid \$31.4 million for the note hedges. The Notes are classified as a non-current liability on our consolidated balance sheet as of December 31, 2013

### Credit Facility

On June 29, 2012, we terminated a revolving credit facility scheduled to expire in February 2013. The credit facility provided for a \$20.0 million line of credit. At the time of termination, no borrowings other than a letter of credit in the face amount of \$850,000 were outstanding under the credit facility.

On July 5, 2012, we entered into a new three-year credit agreement (the "Credit Agreement"). The Credit Agreement provides for a secured revolving line of credit based on eligible accounts receivable in an amount up to \$25.0 million on and before July 5, 2013 and up to \$30.0 million thereafter, in each case with a \$2.0 million letter of credit sublimit. Proceeds available under the Credit Agreement may be used for working capital and other general corporate purposes. We have the option to prepay the loans under the Credit Agreement in whole or in part at any time without premium or penalty. We also have the option to terminate the commitments under the Credit Agreement in whole at any time, and may reduce the commitments by up to \$10.0 million between July 1, 2013 and June 30, 2014.

The loans under the Credit Agreement bear interest, at our option, at a base rate determined in accordance with the Credit Agreement, minus 0.50%, or at a LIBOR rate plus 2.00%. Principal, together with all accrued and unpaid interest, is due and payable on July 5, 2015, the maturity date. We are also obligated to pay a quarterly commitment fee, payable in arrears, based on the available commitments.

The Credit Agreement contains customary affirmative and negative covenants, as well as financial covenants. Affirmative covenants include, among others, delivery of financial statements, compliance certificates and notices of specified events, maintenance of properties and insurance, preservation of existence, and compliance with applicable laws and regulations. Negative covenants include, among others, limitations on the ability of us and our subsidiaries to grant liens, incur indebtedness, engage in mergers, consolidations and sales of assets and engage in affiliate transactions. The Credit Agreement requires us to maintain a maximum leverage ratio and a minimum liquidity amount, each as defined in the Credit Agreement.

The Credit Agreement also contains customary events of default including, among other things, payment defaults, breaches of covenants or representations and warranties, cross-defaults with certain other indebtedness, bankruptcy and insolvency events and change in control of the Company, subject to grace periods in certain instances. Upon an event of default, the lender may declare the outstanding obligations of the Company under the Credit Agreement to be immediately due and payable and exercise other rights and remedies provided for under the Credit Agreement.

Our obligations under the Credit Agreement are guaranteed by our subsidiary, ServiceSource Delaware, Inc., and are collateralized by substantially all of our assets and our subsidiary's assets.



Summary Cash Flows

The following table sets forth a summary of our cash flows for the periods indicated:

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	Years Ended December 31,		
	2013	2012	2011
	(in thousands)		
Net cash (used in) provided by operating activities	\$15,675	\$10,502	\$(11,231 )
Net cash used in investing activities	(82,472 )	(10,889 )	(57,542 )
Net cash provided by financing activities	159,765	11,092	112,181
Net increase in cash and cash equivalents, net of impact of foreign exchanges on cash and cash equivalents	\$93,564	\$10,585	\$43,331

**Operating Activities**

In 2013, net cash provided by operating activities was \$15.7 million. Our net loss during the period was \$22.9 million, adjusted by non-cash charges of \$11.7 million for depreciation and amortization, \$23.6 million for stock-based compensation and \$2.8 million of amortization of debt discount and issuance costs. Cash provided for operations resulted from changes in our working capital, including a \$3.8 million increase in accrued compensation and benefits, a \$3.6 million increase in accrued liabilities and other, and a \$0.5 million increase in accounts payable. Uses of cash were related to a \$7.5 million increase in accounts receivable and a \$1.3 million increase in prepaid expenses. Our working capital management, particularly around accounts receivable and accrued compensation and benefits, contributed to an improvements in our net cash flows from operations in 2013.

In 2012, net cash provided by operating activities was \$10.5 million. Our net loss during the period was \$42.8 million, which was impacted by a non-cash valuation allowance of \$33.1 million for a substantial portion of our deferred tax assets and adjusted by non-cash charges of \$10.0 million for depreciation and amortization and \$20.9 million for stock-based compensation. Cash provided for operations resulted from changes in our working capital, including a \$7.5 million increase in other accrued liabilities and a \$3.8 million decrease in prepaid balances. Uses of cash were related to an \$11.2 million increase in accounts receivable, a \$6.2 million decrease in accrued compensation and benefits and a \$2.5 million decrease in accounts payable.

In 2011, net cash used in operating activities was \$11.2 million. Our net income during the period was \$15.1 million which reflected a one-time non-cash tax benefit of \$20.7 million as a result of recognition of deferred tax assets resulting from our election to be subject to taxation as a corporation. The net income was adjusted by non-cash charges of \$9.4 million for depreciation and amortization and \$11.6 million for stock-based compensation. Cash used for operations during 2011 principally resulted from \$18.1 million in payments to Oracle/Sun and the related settlement of accrued payables owed to Oracle/Sun and amounts owed to us by Oracle/Sun. Additional uses of cash were related to a \$1.4 million increase in prepaid expenses and other assets and a \$5.0 million increase in accounts receivable. Sources of cash resulted from changes in our working capital, including a \$6.9 million increase in accrued compensation and benefits, a \$2.2 million increase in accounts payable, a \$2.0 million increase in other accrued liabilities and a \$1.8 million increase in accrued taxes.

**Investing Activities**

In 2013 cash used for investing activities was principally to purchase of short-term investments, net sales and maturities of \$72.7 million, and to a lesser extent for purchases of property and equipment of \$5.3 million and as investments of \$4.5 million in a privately held company.

In 2012 cash used for investing activities related to purchases of property and equipment totaled \$20.0 million, including costs capitalized for development of internal-use software and leasehold improvements associated with our offices, partially offset by net proceeds from sales and maturities of short-term of investments \$9.5 million.

In 2011 net cash used in investing activities was \$57.5 million. In 2011, cash used in investing activities was principally for the purchases of short-term investments, net of sales and maturities, of \$43.5 million and to a lesser extent, for purchase of property and equipment of \$14.0 million, including costs capitalized for development of internal-use software.

**Financing Activities**

Cash provided by financing activities was \$159.8 million during 2013 and comprised primarily from proceeds from issuance of convertible notes of \$145.1 million, issuance of warrants of \$21.8 million, and option exercises and the

purchase of common stock under our employee stock purchase plan of \$25.0 million. These proceeds were partially offset by our payment of \$31.4 million for the convertible note hedges.

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Cash provided by financing activities was \$11.0 million during 2012 and principally resulted from proceeds of \$10.4 million from the exercise of common stock options and the purchase of common stock under our employee stock purchase plan.

Cash provided by financing activities was \$112.2 million during 2011 and comprised primarily of proceeds from our IPO, net of issuance costs, of \$87.7 million and proceeds from our follow-on offering, net of issuance costs of \$23.0 million. In addition we received proceeds of \$15.0 million from the exercise of common stock options and the purchase of common stock under our employee stock purchase plan, partially offset by \$16.3 million in net payments to pay off our term loan and for payment under capital lease obligations.

**Off-Balance Sheet Arrangements**

We do not have any relationships with other entities or financial partnerships, such as entities often referred to as structured finance or special-purpose entities, which have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes

**Contractual Obligations and Commitments**

Our principal commitments consist of obligations under operating leases for office space and computer equipment, and purchase commitments and unrecognized tax benefits during our normal course of business.

At December 31, 2013, the future minimum payments under these commitments were as follows (in thousands):

	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Obligations under capital leases	\$657	\$270	\$237	\$150	\$—
Operating lease obligations	38,284	8,428	15,280	10,109	4,467
Purchase obligations	5,439	3,188	2,251	—	—
	\$44,380	\$11,886	\$17,768	\$10,259	\$4,467

The contractual commitment amounts in the table above are associated with agreements that are enforceable and legally binding, which specify significant terms, including payment terms, related services and the approximate timing of the transaction. Obligations under contracts that we can cancel without a significant penalty are not included in the table above.

Also excluded from the table above is the income tax liability we recorded for the difference between the benefit recognized and measured and the tax position taken or expected to be taken on our tax returns (“unrecognized tax benefits”). As of December 31, 2013, our liability for unrecognized tax benefits was \$0.1 million. Reasonably reliable estimates of the amounts and periods of related future payments cannot be made at this time.

**Critical Accounting Policies and Estimates****Revenue Recognition**

Our revenue is derived primarily from recurring revenue management. Other revenues which have not been significant, include subscriptions to our cloud applications and professional services

Revenue is recognized when all of the following criteria have been met:

• Persuasive evidence of an arrangement exists. Customer contracts are generally used to determine the existence of an arrangement.

• Delivery has occurred. Upon customer acceptance and when we have no significant remaining obligations.

• The fee is fixed or determinable. We assess whether the fee is fixed or determinable based on the payment terms associated with the transaction and whether the selling price is subject to refund or adjustment.

Collectability is reasonably assured. We assess collectability based primarily on the creditworthiness of the customer as determined by credit checks and analysis, as well as the customer's payment history.

#### Recurring Revenue Management

Revenue from recurring revenue management consists of fees earned from the sales of services contracts on behalf of our customers or assisting our customers in their sales process. Our contract obligations include administering and managing the

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sales and/or renewal process for our customer's service contracts, providing adequately trained staff, reporting, and holding periodic business reviews with our customers. Under our contracts, customers are obligated to provide us with a detailed listing of sales prospects, access to their databases or management systems, and sales and marketing materials. Our fees are generally calculated as a fixed percentage of the overall sales value associated with the successful renewal of service contracts sold on behalf of our customers. In addition, many of our customer contracts include performance-based fees determined by the achievement of specified performance metrics. Our recurring revenue management contracts typically entitle us to additional fees and adjustments resulting from instances where our customers fail to provide us with a specified minimum value of contract renewals or they fail to provide contract renewal data within the time frames specified in our contract. We also receive termination fees in the event a customer cancels a contract without cause prior to its terminations date. Our recurring revenue management contracts can also be cancelled by our customers without a termination fee if we fail to achieve certain performance levels.

Our fees from recurring revenue management services are recognized on a net basis since we act as an agent on behalf of our customers. We do not perform the underlying maintenance services; determine pricing, terms or scope of services to our customer's end users. Performance incentive fees and early termination fees are recorded in the period when the performance criteria have been met.

### Subscriptions and Professional Services

Subscription revenue is comprised of subscriptions fees to access our cloud based applications, and professional services is generated from implementation and project based services. Subscription revenue is recognized ratably over the contract term, commencing when our cloud applications are made available to our customers. Our subscription service arrangements are generally non-cancelable and do not contain refund-type provisions. Professional services are deemed delivered and revenue recognized upon the successful completion of implementation projects or when project milestones have been achieved and accepted by the customer.

### Multiple-Deliverable Arrangements

We have entered into a limited number of multiple element arrangements wherein our customers utilize a combination of recurring revenue management services, subscriptions to our cloud applications and professional services. We separate deliverables at the inception of the arrangement as if each deliverable has stand-alone value to our customer. Arrangement consideration is allocated based on the relative selling prices of each deliverable. However, substantially all fees earned from our recurring revenue management services are contingent in nature as the commissions we earn are based on our performance against the specific terms of each contract. Therefore, contingent fees from revenue management services are excluded from the allocation of relative selling prices at inception of our multiple element arrangements.

According to the accounting guidance prescribed in Accounting Standards Codification (ASC) 605, Revenue Recognition, selling prices for each deliverable is determined based on the selling price hierarchy of vendor-specific objective evidence (VSOE), third-party evidence (TPE), and best estimated selling price (BESP). We have not been able to establish VSOE for our deliverables due to the customer-specific nature of our products and services. Also, we have not been able to reliably determine the stand-alone selling prices of competitor's products and services, and as a result, we cannot rely on TPE for our deliverables. Therefore, we utilize estimates of BESP to determine the selling prices of our deliverables. BESP is determined through consultation with management, taking into consideration our marketing and pricing strategies. As these strategies evolve, we may modify our pricing practices in the future, which could result in changes in the estimates used to estimate BESP which could change the allocation of revenue for our multiple element arrangements.

### Stock-Based Compensation

We measure and recognize compensation expense for share-based payment awards made to our employees and directors, including employee stock options and restricted stock units, based on the grant-date fair values of the awards.

We estimate the fair value of stock options granted 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 historical volatility and the number of options that will be forfeited prior to vesting. The fair value is then amortized on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period. Changes in these estimates and assumptions can materially affect the determination of the fair value of share-based compensation and consequently, the related amount recognized in our consolidated statements of operations.

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The compensation expense of restricted stock units and performance based restricted stock awards is determined using the fair value of our common stock on the date of grant, and the expense is recognized on a straight-line basis over the vesting period.

### Income Taxes

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 regularly assess the need for a valuation allowance against our deferred tax assets. In making that assessment, we consider both positive and negative evidence related to the likelihood of realization of the deferred tax assets on a jurisdictional basis to determine, based on the weight of available evidence, whether it is more likely than not that some or all of the deferred tax assets will not be realized. Examples of positive and negative evidence include future growth, forecasted earnings, future taxable income, the mix of earnings in the jurisdictions in which we operate, historical earnings, taxable income in prior years, if carryback is permitted under the law and prudent and feasible tax planning strategies. In the event we were to determine that we would not be able to realize all or part of our net deferred tax assets in the future, an adjustment to the deferred tax assets valuation allowance would be charged to earnings in the period in which we make such a determination, or goodwill would be adjusted at our final determination of the valuation allowance related to an acquisition within the measurement period. If we later determine that it is more likely than not that the net deferred tax assets would be realized, we would reverse the applicable portion of the previously provided valuation allowance as an adjustment to earnings at such time.

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. We recognize interest accrued and penalties related to unrecognized tax benefits in the income tax provision. 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.

### Recent Accounting Pronouncements

See "Note 2. Summary of Significant Accounting Policies" of the Notes to Consolidated Financial Statements in Item 8. Financial Statements and Supplementary Data for a full description of recent accounting pronouncements including the respective expected dates of adoption and effects on Consolidated Balance Sheets and Consolidated Statements of Operations.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

### Foreign Currency Risk

Our results of operations and cash flows are subject to fluctuations due to changes in foreign currency exchange rates, particularly changes in the Euro, British pound, Singapore dollar and Malaysian Ringgit. To date, we have not entered into any foreign currency hedging contracts, but may consider entering into such contracts in the future. We believe our operating activities act as a natural hedge for a substantial portion of our foreign currency exposure because we typically collect revenue and incur costs in the currency in the location in which we provide our solution from our sales centers. However, our global sales operations center in Kuala Lumpur incurs costs in the Malaysian Ringgit but we do not generate revenue or cash proceeds in this currency and, as a result, have some related foreign currency risk exposure. As our international operations grow, we will continue to reassess our approach to managing our risk



relating to fluctuations in currency rates.

We performed a sensitivity analysis of our foreign currency exposure at December 31, 2013 to assess the potential impact of fluctuations in exchange rates for all foreign denominated assets and liabilities. A 10% appreciation or depreciation for all currencies against the U.S. dollar at December 31, 2013 would not have had a material impact on our results of operations or our cash flows.

Interest Rate Risk

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At December 31, 2013, we had cash and cash equivalents of \$170.1 million and short-term investments of \$105.0 million, which primarily consisted of corporate bonds, agency securities, asset-backed securities and U.S. treasury. The carrying amount of our cash equivalents reasonably approximates fair value due to the short maturities of these instruments. The primary objectives of our investment activities are the preservation of capital, the fulfillment of liquidity needs and the fiduciary control of cash and investments. We do not enter into investments for trading or speculative purposes. Our investments are exposed to market risk due to fluctuations in interest rates, which may affect our interest income and the fair market value of our investments. Due to the short-term nature of our investment portfolio, however, we do not believe an immediate 10% increase or decrease in interest rates would have a material effect on the fair market value of our portfolio. We therefore do not expect our operating results or cash flows to be materially affected by a sudden change in market interest rates. We do not believe our cash equivalents have significant risk of default or illiquidity. While we believe our cash equivalents do not contain excessive risk, we cannot provide absolute assurance that in the future our investments will not be subject to adverse changes in market value. In addition, we maintain significant amounts of cash and cash equivalents at one or more financial institutions that are in excess of federally insured limits. We cannot be assured that we will not experience losses on these deposits

As of December 31, 2013, we had \$150.0 million aggregate principal amount of convertible senior notes outstanding and capital lease obligations of \$0.7 million, all of which are fixed rate instruments. Therefore, our results of operations are not subject to fluctuations in interest rates.

**Inflation Risk**

We do not believe that inflation has had a material effect on our business, financial condition or results of operations. Nonetheless, if our costs were to become subject to significant inflationary pressures, we may not be able to fully offset such higher costs through price increases. Our inability or failure to do so could harm our business, financial condition and results of operations.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

ServiceSource International, Inc.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SCHEDULE

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<u>Consolidated Statements of Comprehensive Income (Loss) for the years ended December 31, 2013, 2012 and 2011</u>	<u>53</u>
<u>Consolidated Statements of Stockholders'/Members' Equity for the years ended December 31, 2013, 2012 and 2011</u>	<u>54</u>
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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of  
ServiceSource International, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, comprehensive income (loss), stockholders'/members' equity and cash flows present fairly, in all material respects, the financial position of ServiceSource International, Inc. and its subsidiaries at December 31, 2013 and December 31, 2012, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2013 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control - Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits (which were integrated audits in 2013 and 2012). We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP  
San Jose, California  
March 7, 2014



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ServiceSource International, Inc.  
 Consolidated Balance Sheets  
 (In thousands, except per share amounts)

	December 31,	
	2013	2012
Assets		
Current assets:		
Cash and cash equivalents	\$ 170,132	\$ 76,568
Short-term investments	105,001	32,874
Accounts receivable, net	73,113	65,238
Deferred income taxes	412	389
Prepaid expenses and other	6,295	5,178
Total current assets	354,953	180,247
Property and equipment, net	27,998	34,513
Deferred income taxes, net of current portion	2,035	2,321
Other assets, net	8,626	1,057
Goodwill	6,334	6,334
Total assets	\$ 399,946	\$ 224,472
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 3,610	\$ 3,293
Accrued taxes	1,134	1,056
Accrued compensation and benefits	19,610	15,738
Other accrued liabilities	15,144	10,403
Obligations under capital leases	270	326
Total current liabilities	39,768	30,816
Obligations under capital leases, net of current portion	387	638
Convertible notes, net	113,915	—
Other long-term liabilities	5,179	6,091
Total liabilities	159,249	37,545
Commitments and contingencies (Note 10)		
Stockholders' equity:		
Preferred stock, \$0.001 par value; 20,000,000 shares authorized and none issued and outstanding	—	—
Common stock; \$0.0001 par value; 1,000,000 shares authorized, 82,086 shares issued and 81,965 shares outstanding as of December 31, 2013; 75,758 shares issued and 75,637 shares outstanding at December 31, 2012	8	8
Treasury stock	(441	) (441
Additional paid-in capital	286,526	210,650
Accumulated deficit	(46,250	) (23,398
Accumulated other comprehensive income	854	108
Total stockholders' equity	240,697	186,927
Total liabilities and stockholders' equity	\$ 399,946	\$ 224,472
The accompanying notes are an integral part of these consolidated financial statements.		



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ServiceSource International, Inc.  
 Consolidated Statements of Operations  
 (In thousands, except per share amounts)

	Years Ended December 31,		
	2013	2012	2011
Net revenue	\$272,482	\$243,703	\$205,501
Cost of revenue	162,449	136,321	113,406
Gross profit	110,033	107,382	92,095
Operating expenses:			
Sales and marketing	58,826	56,925	48,520
Research and development	23,855	19,255	13,073
General and administrative	44,913	41,135	33,647
Total operating expenses	127,594	117,315	95,240
Loss from operations	(17,561	) (9,933	) (3,145
Other income (expense):			
Interest expense	(3,754	) (236	) (503
Other, net	(666	) (538	) (624
Loss before income taxes	(21,981	) (10,707	) (4,272
Income tax provision (benefit)	871	32,107	(19,383
Net income (loss)	\$(22,852	) \$(42,814	) \$15,111
Net income (loss) per common share:			
Basic	(0.29	) \$(0.58	) \$0.23
Diluted	\$(0.29	) \$(0.58	) \$0.21
Weighted-average shares used in computing net income (loss) per common share:			
Basic	78,408	74,270	66,656
Diluted	78,408	74,270	73,585

The accompanying notes are an integral part of these consolidated financial statements.



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ServiceSource International, Inc.

Condensed Consolidated Statements of Comprehensive Income (Loss)

(In thousands)

	Years Ended December 31,		
	2013	2012	2011
Net income (loss)	\$(22,852	) \$(42,814	) \$15,111
Other comprehensive income:			
Foreign currency translation adjustments	579	(110	) 65
Unrealized gain (loss) on short-term investments, net of tax	167	(20	) 9
Total other comprehensive income (loss), net of tax	746	(130	) 74
Total comprehensive income (loss), net of tax	\$(22,106	) \$(42,944	) \$15,185

The accompanying notes are an integral part of these consolidated financial statements.

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ServiceSource International, Inc.  
 Consolidated Statements of Stockholders'/Members' Equity  
 (In thousands)

	Common Shares		Common Stock		Treasury Shares/Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount	Shares	Amount	Shares	Amount				
Balances at January 1, 2011	57,627	\$34,161	—	\$—	(121 )	\$(441 )	\$—	\$—	\$ 164	\$33,884
Conversion to corporation	(57,760)	(32,573 )	57,760	6	—	—	40,684	—	—	8,117
Issuance of common stock in connection with initial public offering, net of issuance costs of \$10,209	—	—	9,791	1	—	—	87,701	—	—	87,702
Issuance of common stock in connection with follow-on offering, net of issuance costs of \$1,055	—	—	1,372	—	—	—	22,956	—	—	22,956
Issuance of common stock from exercise of stock options and employee stock purchase plan	133	476	3,765	—	—	—	14,569	—	—	15,045
Stock-based compensation	—	2,241	—	—	—	—	9,358	—	—	11,599
Income tax benefit from stock-based compensation	—	—	—	—	—	—	2,528	—	—	2,528
Comprehensive income:										
Net income	—	(4,305 )	—	—	—	—	—	19,416	—	15,111
Other comprehensive income	—	—	—	—	—	—	—	—	74	74
Total comprehensive income										15,185
Balances at January 1, 2012	—	—	72,688	\$ 7	(121 )	(441 )	177,796	19,416	238	197,016
Issuance of common stock from exercise of stock options, vesting of RSU's and	—	—	2,570	1	—	—	10,483	—	—	10,484

employee stock purchase plan										
Stock-based compensation	—	—	—	—	—	—	20,883	—	—	20,883
Income tax benefit from stock-based compensation	—	—	—	—	—	—	1,488	—	—	1,488
Comprehensive loss:										
Net loss	—	—	—	—	—	—	—	(42,814 )	—	(42,814 )
Other comprehensive loss	—	—	—	—	—	—	—	—	(130 )	(130 )
Total comprehensive loss										(42,944 )
Balances at January 1, 2013	—	—	75,258	8	(121 )	(441 )	210,650	(23,398 )	108	186,927
Issuance of common stock from exercise of stock options and employee stock purchase plan	—	—	5,887	—	—	—	24,976	—	—	24,976
Vested restricted stock units converted to shares	—	—	514	—	—	—	—	—	—	—
Equity component of the convertible notes issuance, net	—	—	—	—	—	—	37,297	—	—	37,297
Sale of warrants	—	—	—	—	—	—	21,763	—	—	21,763
Purchase of convertible note hedges	—	—	—	—	—	—	(31,408 )	—	—	(31,408 )
Stock-based compensation	—	—	—	—	—	—	23,608	—	—	23,608
Income tax deficiency from stock-based compensation	—	—	—	—	—	—	(360 )	—	—	(360 )
Comprehensive loss:										
Net loss	—	—	—	—	—	—	—	(22,852 )	—	(22,852 )
Other comprehensive gain	—	—	—	—	—	—	—	—	746	746
Total comprehensive loss										(22,106 )
Balances at December 31, 2013	—	\$—	81,659	\$ 8	(121 )	\$(441 )	\$286,526	\$(46,250)	\$ 854	\$240,697

The accompanying notes are an integral part of these consolidated financial statements.

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ServiceSource International, Inc.  
Consolidated Statements of Cash Flows  
(In thousands)

	Years Ended December 31,		
	2013	2012	2011
Cash flows from operating activities			
Net income (loss)	\$ (22,852	) \$ (42,814	) \$ 15,111
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	11,652	10,003	9,372
Amortization of debt discount and issuance costs	2,761	149	351
Amortization of premium on short-term investments	750	591	276
Deferred income taxes	217	31,340	(19,259
Stock-based compensation	23,620	20,883	11,599
Tax benefit (deficit) from stock-based compensation	360	(1,488	) (2,835
Changes in operating assets and liabilities:			
Accounts receivable, net	(7,470	) (10,906	) (4,972
Prepaid expenses and other	(1,305	) 3,819	(3,164
Accounts payable	521	(2,473	) 2,235
Accrued taxes	71	115	2,064
Accrued compensation and benefits	3,772	(6,239	) 6,617
Accrued liabilities and other	3,578	7,522	(28,626
Net cash (used in) provided by operating activities	15,675	10,502	(11,231
Cash flows from investing activities			
Acquisition of property and equipment	(5,261	) (20,353	) (14,050
Investment in privately held company	(4,500	) —	—
Purchases of short-term investments	(89,747	) (64,002	) (53,795
Sales of short-term investments	14,436	52,051	2,113
Maturities of short-term investments	2,600	21,415	8,190
Net cash used in investing activities	(82,472	) (10,889	) (57,542
Cash flows from financing activities			
Proceeds from issuance of convertible notes, net	145,133	—	—
Payments of convertible note hedges	(31,408	) —	—
Proceeds from the issuance of warrants	21,763	—	—
Net proceeds from issuance of common stock in initial public offering and follow-on offering.	—	—	110,753
Repayment of long-term debt and capital lease obligations	(329	) (710	) (16,252
Payment of issuance costs for credit facility	—	(141	) (200
Proceeds from common stock issuances	24,966	10,455	15,045
Tax benefit (deficit) from stock-based compensation	(360	) 1,488	2,835
Net cash provided by financing activities	159,765	11,092	112,181
Net increase in cash and cash equivalents	92,968	10,705	43,408
Effect of exchange rate changes on cash and cash equivalents	596	(120	) (77
Cash and cash equivalents at beginning of period	76,568	65,983	22,652
Cash and cash equivalents at end of period	\$ 170,132	\$ 76,568	\$ 65,983
Supplemental disclosure of cash flow information			
Cash paid for interest	\$ 125	\$ 132	\$ 518
Income taxes (refunded) paid, net	1,168	(3,987	) 2,459

Supplemental disclosure of non-cash investing and financing activities

Acquisition of property and equipment under capital leases	—	—	271
Acquisition of property and equipment through accounts payable and accrued liabilities	34	314	1,570

The accompanying notes are an integral part of these consolidated financial statements.

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ServiceSource International, Inc

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. The Company

ServiceSource is a global leader in recurring revenue management, partnering with technology and technology-enabled companies to optimize maintenance, support and subscription revenue streams, while also improving customer relationships and loyalty. The Company delivers these results via a cloud-based solution, with dedicated service teams, leveraging benchmarks and best practices derived from their rich database of service and renewal behavior. By integrating software, managed services and data, the Company provides end-to-end management and optimization of the service-contract renewals process, including data management, quoting, selling and recurring revenue business intelligence. The Company receives commissions from its customers based on renewal sales that the Company generates on their behalf under a pay-for-performance model. In addition, the Company also offers a purpose-built cloud application to maximize the renewal of subscriptions, maintenance and support contracts and receives subscription fees from its customers for the SaaS product. The Company's corporate headquarters is located in San Francisco, California. The Company has additional offices in Colorado, Tennessee, the United Kingdom, Ireland, Malaysia, Singapore and Japan.

2. Summary of Significant Accounting Policies

Basis of Consolidation

The accompanying consolidated financial statements include the accounts of ServiceSource International, Inc. and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amount of net revenue and expenses during the reporting period. The Company's significant accounting judgments and estimates include, but are not limited to: revenue recognition; the valuation and recognition of stock-based compensation, recognition and measurement of current and deferred income tax assets and liabilities and uncertain tax positions and the provision for bad debts.

The Company bases its estimates and judgments on historical experience and on various assumptions that it believes are reasonable under the circumstances. However, future events are subject to change and estimates and judgments routinely require adjustment. Actual results may differ from these estimates, and these differences may be material.

Segments

The Company defines an operating segment on the same basis that it uses internally to evaluate performance. Management has determined that the Company has three operating segments, as it reports financial information across three geographic regions to its chief executive officer, who is the Company's chief operating decision maker. The Company's three operating and reportable segments are NALA (North America and Latin America), EMEA (Europe, Middle East and Africa) and APJ (Asia Pacific-Japan). The Company's three operating segments are also its three reporting units.

Significant Risks and Uncertainties

The Company is subject to certain risks and uncertainties that could have a material and adverse effect on its future financial position or results of operations. The Company's customers are primarily high technology companies and any downturn in these industries, changes in customers' sales strategies, or widespread shift away from end customers purchasing maintenance and support contracts could have an adverse impact on the Company's consolidated results of operations and financial condition.

Financial instruments that potentially subject the Company to concentration of credit risk consist principally of cash, cash equivalents, short-term investments, accounts receivable and the Note Hedges (Note 9). The Company is also exposed to a variety of market risks, including the effects of changes in foreign currency exchange rates and interest

rates.

Cash is maintained in demand accounts at U.S., European and Asian financial institutions that management believes are credit worthy. Deposits in these institutions may exceed the amount of insurance provided on these deposits.

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Accounts receivable are derived from services performed for customers located primarily in the U.S., Europe and Asia. The Company attempts to mitigate the credit risk in its trade receivables through its ongoing credit evaluation process and historical collection experience. The Company maintains an allowance for doubtful accounts based upon the expected collectability of its accounts receivable, which takes into consideration an analysis of historical bad debts and other available information.

The following table summarizes net revenue and accounts receivable from customers, in excess of 10% of total net revenue and accounts receivable, respectively, including the related geographic segments as discussed in Note 14.

	Revenue			Accounts Receivable		
	Years Ended December 31,			December 31,		
	2013	2012	2011	2013	2012	
VMware, Inc (NALA, EMEA and APJ)	14	% 13	% 12	% 14	% 14	%

**Fair Value of Financial Instruments**

The carrying amounts of certain financial instruments, which include cash equivalents, short-term investments, accounts receivable, accounts payable, accrued payables and other accrued liabilities approximates fair value due to their short-term nature.

**Foreign Currency Translation and Remeasurement**

Assets and liabilities of non-U.S. subsidiaries that operate in a local currency environment, where that local currency is the functional currency, are translated to U.S. dollars at exchange rates in effect at the balance sheet date. Net revenue and expenses are translated at monthly average exchange rates. The Company accumulates net translation adjustments in equity as a component of accumulated other comprehensive income (loss). For non-U.S. subsidiaries whose functional currency is the U.S. dollar, transactions that are denominated in foreign currencies have been remeasured in U.S. dollars, and any resulting gains and losses are reported in the accompanying consolidated statements of operations. Foreign currency transaction losses of \$(1.0) million, \$(0.4) million and \$(0.7) million, were included in other (expense) income, net during 2013, 2012 and 2011, respectively.

**Accounts Receivable and Allowance for Doubtful Accounts**

Accounts receivable are stated at their carrying values net of an allowance for doubtful accounts. The Company evaluates the ongoing collectability of its accounts receivable based on a number of factors such as the credit quality of its customers, the age of accounts receivable balances, collections experience, current economic conditions and other factors that may affect a customer's ability to pay. In circumstances where the Company is aware of a specific customer's inability to meet its financial obligations to the Company, a specific allowance for doubtful accounts is estimated and recorded, which reduces the recognized receivable to the estimated amount that management believes will ultimately be collected. Account balances are charged off against the allowance when it is probable that the receivable will not be recovered.

The following are changes in the allowance for doubtful accounts during 2013, 2012 and 2011 (in thousands):

	December 31,		
	2013	2012	2011
Balance, beginning of year	\$253	\$32	\$—
Charged to expense	123	221	32
Recoveries	(248	) —	—
Balance, end of year	\$128	\$253	\$32

**Property and Equipment**

The Company records property and equipment at cost, less accumulated depreciation and amortization. Depreciation is recorded using the straight-line method over estimated useful lives of seven years for office furniture and equipment, two to three years for computer hardware and two to five years for software. Leasehold improvements are amortized on a straight-line basis over the lesser of the lease term or the estimated useful life of the related assets, ranging from three to ten years.



When assets are retired, the cost and accumulated depreciation and amortization are removed from their respective accounts and any loss on such retirement is reflected in operating expenses. When assets are otherwise disposed of, the cost and

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related accumulated depreciation and amortization are removed from their respective accounts and any gain or loss on such sale or disposal is reflected in other income (expense), net.

**Asset Retirement Obligations**

The fair value of a liability for an asset retirement obligation (“ARO”) is recognized in the period in which it is incurred. The Company’s asset retirement obligations are primarily associated with leasehold improvements in APJ, which, at the end of a lease, are contractually obligated to be removed in order to comply with the lease agreement. At the inception of a lease with such conditions, the Company records an ARO liability and a corresponding capital asset in an amount equal to the estimated fair value of the obligation. The associated retirement costs are capitalized and included as part of the carrying value of the long-lived asset and amortized over the useful life of the asset. Upon satisfaction of the ARO conditions, any difference between the recorded ARO liability and the actual retirement costs incurred is recognized as an operating gain or loss in the consolidated statements of earnings. The following table summarizes the activity of the Company’s asset retirement obligation liability (in thousands):

Asset retirement obligations as of December 31, 2011	\$596	
Additions	128	
Accretion expense	28	
Asset retirement obligations as of December 31, 2012	752	
Lease settlement	(365	)
Additions	366	
Accretion expense	25	
Asset retirement obligations as of December 31, 2013	\$778	

**Capitalized Internal-Use Software**

Expenditures for software purchases and software developed or obtained for internal use are capitalized and amortized over a period of two to five years on a straight-line basis. For software developed or obtained for internal use, the Company capitalizes direct external costs associated with developing or obtaining internal-use software. In addition, the Company also capitalizes certain payroll and payroll-related costs for employees who are directly associated with the development of such applications. Costs associated with preliminary project stage activities, training, maintenance and all other post-implementation stage activities are expensed as incurred and are recorded in research and development on the accompanying consolidated statements of operations. Capitalized costs related to internal-use software under development are treated as construction-in-progress until the program, feature or functionality is ready for its intended use, at which time amortization commences.

**Goodwill and Intangible Assets**

Goodwill and intangible assets with indefinite useful lives are not amortized, but are tested for impairment at least annually or as circumstances indicate their value may no longer be recoverable. The Company does not have intangible assets with indefinite useful lives other than goodwill.

To assess if goodwill is impaired a qualitative assessment is first performed to determine whether further impairment testing is necessary. If, as a result of the qualitative assessment, the Company considers it more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, then a quantitative impairment test is performed. This includes a screening for impairment and, in a second step, the measuring of such impairment. The goodwill impairment test is generally performed annually during the fourth fiscal quarter (or earlier if impairment indicators arise). The guidance for goodwill and other intangible assets requires impairment testing based on reporting units. The entire goodwill balance is attributed to the NALA reporting unit. Based on the Company’s results of its qualitative test for goodwill impairment, as of December 31, 2013, it believes that it is more-likely-than-not that the fair value of the NALA reporting unit is greater than its respective carrying value. There was no impairment of goodwill identified during 2013, 2012 and 2011.

**Senior Convertible Notes**

In accounting for the senior convertible notes (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 the 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

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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 for equity classification.

### Impairment of Long-Lived Assets

The Company evaluates the recoverability of its long-lived assets, which include amortizable intangible, including internal-use software and tangible assets. Acquired intangible assets with definite useful lives are amortized over their useful lives on a straight line basis which represents the pattern in which the Company derives benefit from the asset. The Company evaluates long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of long-lived assets may not be recoverable. The Company recognizes such impairment in the event the net book value of such assets exceeds the future undiscounted cash flows attributable to such assets. No impairment losses were incurred in the periods presented.

### Operating Leases

The Company's operating lease agreements for office facilities include provisions for certain rent holidays, tenant incentives and escalations in the base price of the rent payment. The Company records rent holidays and rent escalations on a straight-line basis over the lease term and records the difference between expense and cash payments as deferred rent. Tenant incentives are recorded as deferred rent and amortized on a straight-line basis over the lease term. Deferred rent is included in other accrued liabilities on the accompanying consolidated balance sheets.

### Deferred Debt Issuance Costs

The Company defers debt issuance costs, which primarily consists of the debt discount on the convertible debt and issuance costs related to the convertible debt. Such costs primarily relates to convertible notes (Note 9) and is amortized using the effective interest method over the term of the convertible debt. The amortization of deferred debt issuance costs is recorded as interest expense. Unamortized deferred debt issuance costs were \$39.5 million at December 31, 2013 and \$0.1 million as of December 31, 2012. Amortization of deferred debt issuance costs was \$2.8 million in 2013, \$0.1 million in 2012 and \$0.2 million in 2011, respectively. Estimated future amortization of deferred debt issuance costs expense will approximate \$7.4 million in 2014 and \$8.0 million in 2015 and \$8.7 million in 2016.

### Comprehensive Income (Loss)

Comprehensive income (loss) consists of two components, net income (loss) and other comprehensive income (loss). Other comprehensive income (loss) refers to revenue, expenses, gains and losses recorded as an element of equity but are excluded from net income (loss). The Company's other comprehensive income (loss) consists of foreign currency translation adjustments from those subsidiaries not using the U.S. dollar as their functional currency and unrealized gains and losses on available-for-sale securities. The Company has disclosed accumulated comprehensive other income (loss) as a separate component of stockholders' equity.

### Revenue Recognition

The Company's revenue is derived primary from recurring revenue management. Other revenues which have not been significant, include subscriptions to the Company's cloud applications and professional services

Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable and collectability is reasonably assured from customers and no significant obligations remain unfulfilled by the Company.

### Recurring Revenue Management

Revenue from recurring revenue management consists of fees earned from the sales of services contracts on behalf of the Company's customers or assisting in their sales process. The Company's contract obligations include administering and managing the sales and/or renewal processes for customer contracts; providing adequately trained staff; reporting; and holding periodic business reviews with customers. Customer obligations include providing a detailed listing of sales prospects, access to their databases or systems and sales or marketing materials. Fees are generally based on a fixed percentage of the overall sales value associated with the service contracts. However some customer contracts include performance-based fees determined by the achievement of specified performance metrics. Recurring revenue

management contracts entitle the Company to additional fees and adjustments which are invoked in various circumstances including a customer's failure to provide the

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Company with a specified minimum value of sales prospects, untimely delivery of customer sales prospect data or other obligations inhibiting the Company's ability to perform its obligations. In addition, many customer contracts contain early termination fees.

Recurring revenue management services are deemed delivered when customers accept purchased orders from their sales prospects (the end customer) and no significant post-delivery obligations remain for the Company. Fees from recurring revenue management services are recognized on a net basis since the Company acts as an agent on behalf of its customers. The Company does not provide the services being renewed by the end customers, nor does it determine pricing, terms or scope of services to the end customers. Performance incentive fees and early termination fees are recorded in the period when either the performance criteria have been met or a triggering event has occurred.

### Subscriptions

Subscription revenue is comprised of subscriptions fees to access the Company's cloud based applications.

Subscription revenue is recognized ratably over the contract term, generally over a period of one to three years, commencing when the cloud applications are made available. The Company's subscription service arrangements are generally non-cancelable and do not contain refund-type provisions.

### Professional Services

Professional services revenue is generated from implementation services. Professional services are deemed delivered upon the successful completion of implementation projects or when project milestones have been achieved and accepted by the customer.

### Multiple Element Arrangements

The Company enters into multiple element arrangements when customers utilize a combination of recurring revenue management services, subscriptions and professional services. Deliverables are separated at the inception of the arrangement if each deliverable has stand-alone value to the customer. The Company believes that it has stand-alone value for professional services. Arrangement consideration is allocated based on the relative selling prices of each deliverable. However, most fees earned from recurring revenue management services are contingent in nature as the fees earned by the Company are based on performance against the specific terms of each contract. Therefore, contingent fees from revenue management services are excluded from the allocation of relative selling prices at inception of multiple element arrangements.

Selling prices for each deliverable is determined based on the selling price hierarchy of vendor-specific objective evidence (VSOE), third-party evidence (TPE), and best estimated selling price (BESP). Generally, the Company has not been able to establish VSOE for its deliverables as the items have not been sold separately. The Company has not been able to reliably determine the stand-alone selling prices of competitors' products and services, and therefore cannot rely on TPE for its deliverables. Therefore, the Company utilizes BESP to determine the selling prices of its deliverables. The objective of BESP is to determine the price at which the Company would price a product or service if it were sold on a stand-alone basis. BESP is generally used for offerings that are not typically sold separately or for new offerings including Renew OnDemand. BESP is determined by considering multiple factors including, but not limited to, pricing practices, market conditions, competitive landscape, internal costs, geographies and gross margin. The determination of BESP is made through consultation with and formal approval with management, taking into consideration the Company's marketing strategy. As these marketing strategies evolve, the Company may modify its pricing practices in the future, which could result in changes to selling prices.

Once arrangement consideration is allocated to the various deliverables in a multiple element arrangement, revenue is recognized when all other revenue recognition criteria has been achieved.

### Advertising Costs

Advertising is expensed as incurred as a component of sales and marketing expenses on the consolidated statement of operations. Advertising expense was \$0.1 million during 2013, \$1.1 million during 2012 and \$0.6 million during 2011.

Income Taxes

The Company accounts 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

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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.

The Company files U.S. federal and state and foreign income tax returns in jurisdictions with varying statutes of limitations. In the normal course of business the Company is subject to examination by taxing authorities throughout the world. These audits include questioning the timing and amount of deductions, the allocation of income among various tax jurisdictions and compliance with federal, state, local and foreign tax laws. The Company accounts 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. The Company establishes reserves for tax-related uncertainties based on estimates of whether, and the extent to which, additional taxes will be due. The Company records 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. The Company recognizes interest accrued and penalties related to unrecognized tax benefits in the income tax provision.

**Stock-Based Compensation**

The Company measures and recognizes compensation expense for all share-based awards made to employees and directors based on estimated fair values. The fair value of employee and director options is estimated on the date of grant using the Black-Scholes option-pricing model. The value of awards that are ultimately expected to vest is recognized as an expense over the requisite service periods. Since share-based compensation expense is based on awards ultimately expected to vest, it is reduced for expected forfeitures.

For awards that are expected to result in a tax deduction, a deferred tax asset is established as the Company recognizes compensation expense. If the tax deduction exceeds the cumulative recorded compensation expense, the tax benefit associated with the excess deduction is considered a windfall benefit. The excess tax benefit from share compensation plans is recorded in members' equity and classified as a financing cash flow on the consolidated statements of cash flows.

**Net Income (Loss) Per Common Share**

Basic net income (loss) per share is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during the period. Diluted net income (loss) per share is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during the period increased to include the number of additional shares of common stock that would have been outstanding if the potentially dilutive securities had been issued. Potentially dilutive securities include outstanding stock options, shares to be purchased under the Company's employee stock purchase plan and unvested restricted stock units ("RSUs"). The dilutive effect of potentially dilutive securities is reflected in diluted earnings per share by application of the treasury stock method. Under the treasury stock method, an increase in the fair market value of the Company's common stock can result in a greater dilutive effect from potentially dilutive securities.

**Recent Accounting Pronouncements**

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

**3. Net Income (Loss) Per Common Share**

The basic and diluted net income (loss) per share calculations are presented below (in thousands, except for per share amounts):



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	Years Ended December 31,		
	2013	2012	2011
Basic net income (loss) per common share			
Net income (loss)	\$ (22,852	) \$ (42,814	) \$ 15,111
Weighted-average common shares outstanding	78,408	74,270	66,656
Basic net income (loss) per share	\$ (0.29	) \$ (0.58	) \$ 0.23

	Years Ended December 31,		
	2013	2012	2011
Diluted net income (loss) per common share			
Net income (loss) used to determine diluted earnings per common shares	\$ (22,852	) \$ (42,814	) \$ 15,111
Weighted-average common shares outstanding used in basic calculation	78,408	74,270	66,656
Adjustment for dilutive potential shares	—	—	6,929
Weighted-average common shares for diluted net income (loss) per share	78,408	74,270	73,585
Diluted net income (loss) per share	\$ (0.29	) \$ (0.58	) \$ 0.21

Potential shares of common stock that are not included in the determination of diluted net income per share because they are anti-dilutive for the periods presented consist of weighted stock options, non-vested restricted stock, and shares to be purchased under our ESPP having an anti-dilutive effect of 2.0 million, 4.1 million and 0.8 million shares for the years ended December 31, 2013, 2012 and 2011, respectively.

#### 4. Cash, cash equivalents and short-term investments

Cash equivalents consist of highly liquid fixed-income investments with original maturities of three months or less at the time of purchase. The Company has cash and cash equivalents held on its behalf by a third party of \$0.5 million and \$0.8 million as of December 31, 2013 and 2012 respectively. Short-term investments consist of readily marketable securities with a remaining maturity of more than three months from time of purchase. The Company classifies all of its cash equivalents and short-term investments as “available for sale,” as these investments are free of trading restrictions. These marketable securities are carried at fair value, with the unrealized gains and losses, net of tax, reported as accumulated other comprehensive income and included as a separate component of stockholders’ equity. Gains and losses are recognized when realized. When the Company determines that an other-than-temporary decline in fair value has occurred, the amount of the decline that is related to a credit loss is recognized in earnings. Gains and losses are determined using the specific identification method. The Company’s realized gains and losses in the years ended December 31, 2013 and 2012 were insignificant.

Cash and cash equivalents and short-term investments consisted of the following as of December 31, 2013 and 2012 (in thousands):

December 31, 2013

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	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Cash	\$ 169,968	\$—	\$—	\$ 169,968
Cash equivalents:				
Money market mutual funds	164	—	—	164
Total cash and cash equivalents	170,132	—	—	170,132
Short-term investments:				
Corporate bonds	40,503	90	(10	) 40,583
U.S. agency securities	31,720	40	(13	) 31,747
Asset-backed securities	15,880	14	(12	) 15,882
U.S. Treasury securities	16,742	50	(3	) 16,789
Total short-term investments	104,845	194	(38	) 105,001
Cash, cash equivalents and short-term investments	\$ 274,977	\$ 194	\$(38	) \$ 275,133

December 31, 2012

	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Cash	\$ 59,568	\$—	\$—	\$ 59,568
Cash equivalents:				
Money market mutual funds	17,000	—	—	17,000
Total cash and cash equivalents	76,568	—	—	76,568
Short-term investments:				
Corporate bonds	13,389	2	(14	) 13,377
U.S. agency securities	11,280	4	(1	) 11,283
Asset-backed securities	4,670	1	(5	) 4,666
U.S. Treasury securities	3,546	2	—	3,548
Total short-term investments	32,885	9	(20	) 32,874
Cash, cash equivalents and short-term investments	\$ 109,453	\$ 9	\$(20	) \$ 109,442

The following table summarizes the cost and estimated fair value of short-term fixed income securities classified as short-term investments based on stated effective maturities as of December 31, 2013 (in thousands):

	Amortized Cost	Estimated Fair Value
Less than 1 year	\$ 10,168	\$ 10,174
Due in 1 to 5 years	94,677	94,827
Total	\$ 104,845	\$ 105,001

As of December 31, 2013, the Company did not consider any of its investments to be other-than-temporarily impaired.

## 5. 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 December 31, 2013 and indicates the fair value hierarchy of the valuation (in thousands):

Description	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Cash equivalents:			
Money market mutual funds	\$ 164	\$ 164	\$—
Total cash equivalents	164	164	—
Short-term investments:			
Corporate bonds	40,583	—	40,583
U.S. agency securities	31,747	—	31,747
Asset-backed securities	15,882	—	15,882
U.S. Treasury securities	16,789	—	16,789
Total short-term investments	105,001	—	105,001
Cash equivalents and short-term investments	\$ 105,165	\$ 164	\$ 105,001

The following table presents the financial instruments that are measured and carried at cost on a nonrecurring basis as of December 31, 2013 (in thousands):

Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investment in privately held company \$4,500	\$—	\$—	\$4,500

The following table presents information about the Company's financial instruments that are measured at fair value as of December 31, 2012 and indicates the fair value hierarchy of the valuation (in thousands):



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Description	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Cash equivalents:			
Money market mutual funds	\$17,000	\$17,000	\$—
Total cash equivalents	17,000	17,000	—
Short-term investments:			
Corporate bonds	13,377	—	13,377
U.S. agency securities	11,283	—	11,283
Asset-backed securities	4,666	—	4,666
U.S. Treasury securities	3,548	—	3,548
Total short-term investments	32,874	—	32,874
Cash equivalents and short-term investments	\$49,874	\$17,000	\$32,874

The convertible notes issued by the Company in August 2013 are shown in 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 December 31, 2013 was \$141.2 million. 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 financial instruments measured at fair value or any long-term debt as of December 31, 2012.

#### 6. Property and Equipment, Net

Property and equipment balances were comprised of the following (in thousands):

	December 31,	
	2013	2012
Computers and equipment	\$14,675	\$14,733
Software	34,467	32,982
Leasehold improvements	11,493	10,801
Furniture and fixtures	9,078	8,555
	69,713	67,071
Less: accumulated depreciation and amortization	(41,715)	(32,558)
	27,998	34,513

Depreciation and amortization expense during the year ended December 31, 2013, December 31, 2012 and December 31, 2011, was \$11.7 million, \$10.0 million and \$9.4 million, respectively.

Total property and equipment assets under capital lease at December 31, 2013 and December 31, 2012, was \$3.2 million and \$3.2 million, respectively. Accumulated depreciation related to assets under capital lease as of these dates were \$2.6 million and \$2.1 million, respectively.

The Company capitalized costs of \$0, \$6.2 million and \$6.0 million, during 2013, 2012 and 2011, respectively, related to internal-use software. As of December 31, 2013 and 2012, the carrying value of capitalized costs related to internal-use software, net of accumulated amortization, was \$9.3 million and \$13.6 million, respectively. Amortization of capitalized costs related to internal-use software was \$4.4 million, \$3.0 million and \$3.9 million during 2013, 2012 and 2011, respectively.

7. Other Accrued Liabilities

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

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	December 31,	
	2013	2012
Deferred revenue	\$5,905	\$2,295
Accrued professional fee	2,527	3,664
Deferred rent obligations	834	986
Other employee related	374	323
ESPP contributions	892	1,059
Accrued other	4,612	2,076
	15,144	10,403

## 8. Credit Facility and Capital Leases

## Revolving Credit Facility

Effective June 29, 2012, the Company terminated a \$20.0 million credit facility. At the time of the termination, no borrowings were outstanding other than a letter of credit in the face amount of \$850,000.

Then, on July 5, 2012, the Company, entered into a three-year credit agreement which provides for a secured revolving line of credit based on eligible accounts receivable of up to \$25.0 million on and before July 5, 2013 and up to \$30.0 million thereafter, in each case with a \$2.0 million letter of credit sublimit. On June 18, 2013, the Company elected to maintain the revolving commitment at \$25.0 million rather than have it increase to \$30.0 million on July 5, 2013. Proceeds available under the credit agreement may be used for working capital and other general corporate purposes. The Company may prepay borrowing under the agreement in whole or in part at any time without premium or penalty. The Company may terminate the commitments under the credit agreement in whole at any time, and may reduce the commitments by up to \$10.0 million between July 1, 2013 and June 30, 2014. On June 30, 2013, the Company amended the credit agreement to reduce the quarterly commitment fee, payable in arrears, based on the available commitments from the existing 0.45% rate to 0.30%.

On August 6, 2013, the Company entered into a second amendment ("Amendment No. 2") to the credit agreement. Amendment No. 2, among other things, allowed the Company to issue certain unsecured convertible notes and enter into related agreements.

Amounts outstanding on the facility at December 31, 2013 consisted of a letter of credit for \$575,000 required under an operating lease agreement for office space at the Company's San Francisco headquarters. The loans bear interest, at the Company's option, at a base rate determined in accordance with the credit agreement, minus 0.5%, or at a LIBOR rate plus 2.0%. Principal, together with all accrued and unpaid interest, is due and payable on July 5, 2015, the maturity date. The Company is also obligated to pay a quarterly commitment fee, payable in arrears, based on the available commitments at a rate of 0.30%. At December 31, 2013, the interest rate for borrowings under the facility was 2.2%.

The credit agreement contains customary affirmative and negative covenants, as well as financial covenants. Affirmative covenants include, among others, delivery of financial statements, compliance certificates and notices of specified events, maintenance of properties and insurance, preservation of existence, and compliance with applicable laws and regulations. Negative covenants include, among others, limitations on the ability of the Company to grant liens, incur indebtedness, engage in mergers, consolidations, sales of assets and affiliate transactions. The credit agreement requires the Company to maintain a maximum leverage ratio and a minimum liquidity amount, each as defined in the credit agreement.



The credit agreement also contains customary events of default including, among other things, payment defaults, breaches of covenants or representations and warranties, cross-defaults with certain other indebtedness, bankruptcy and insolvency events and a change in control of the Company, subject to grace periods in certain instances. Upon an event of default, the lender may declare the outstanding obligations of the Company under the credit agreement to be immediately due and payable and exercise other rights and remedies provided for under the credit agreement.

The Company's obligations under the credit agreement are guaranteed by its subsidiary, ServiceSource Delaware, Inc. (the "Guarantor") and are collateralized by substantially all of the assets of the Company and the Guarantor.  
Capital Leases

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The Company has capital lease agreements that are collateralized by the underlying property and equipment and expire through September 2019. The weighted-average imputed interest rates for capital lease agreements were 2.6%, 2.5% and 3.6% at December 31, 2013, 2012 and 2011, respectively.

The future contractual maturities of capital lease obligations as of December 31, 2013 are as follows (in thousands):

Years Ending	
2014	\$270
2015	77
2016	79
2017	81
2018	84
Thereafter	66
Total	\$657

## 9. Convertible Notes

### Senior Convertible Notes

In August 2013, the Company issued senior convertible notes (the "Notes") raising gross proceeds of \$150 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 of each year, commencing 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, including in certain circumstances, upon a make-whole fundamental change (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 anytime 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 by notice to the Company, or the holders of at least 25% in principal amount of the outstanding Notes by notice to the Company and the trustee, may, and the trustee at the request of such holders shall, 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.

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.

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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 are deferred as an asset and amortized to interest expense over the term of the Notes. The transaction costs allocated to the equity component of \$1.3 million were recorded to additional paid-in capital. The transactions costs allocated to the debt component were recorded as deferred offering costs in other non-current assets. The net carrying amount of the liability component of the Notes as of December 31, 2013 consists of the following (in thousands):

Principal amount	\$ 150,000	
Unamortized debt discount	(36,085	)
Net carrying amount	\$ 113,915	

The following table presents the interest expense recognized related to the Notes for the three months ended December 31, 2013 (in thousands):

Contractual interest expense at 1.5% per annum	\$ 563
Amortization of debt issuance costs	153
Accretion of debt discount	1,641
Total	\$2,357

The net proceeds from the Notes were approximately \$145.1 million after payment of the initial purchasers' 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.

**10. Commitments and Contingencies****Operating Leases**

The Company leases its office space and certain equipment under noncancelable operating lease agreements with various expiration dates through September 30, 2022. Rent expense during 2013, 2012 and 2011 was \$8.6 million, \$8.5 million and \$6.5 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.

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Future annual minimum lease payments under all noncancelable operating leases as of December 31, 2013 were as follows (in thousands):

Fiscal Year	
2014	\$8,428
2015	6,362
2016	4,600
2017	4,318
2018	3,756
Thereafter	10,820
Total	\$38,284

## Purchase Orders

The Company had \$5.4 million in non-cancelable purchase commitments with our suppliers as of December 31, 2013.

## Litigation

Bionet Systems, LLC, et al. v. Scout Analytics, Inc., et al., in Superior Court, King County, Washington State  
On January 10, 2014, certain now-former holders of Scout Analytics, Inc. (“Scout”) capital stock filed a lawsuit against Scout and some of its directors and their employers regarding the then-pending acquisition of Scout by the Company. The plaintiffs have asserted claims against all defendants for breach of fiduciary duty, minority shareholder oppression, corporate waste, injunctive relief and unjust enrichment. In their complaint, the plaintiffs seek damages and payment of their attorneys’ fees and costs.

The costs of such litigation are expected to be covered by Scout’s insurance and/or from the escrow amounts held back from the merger consideration paid for Scout and the other indemnification obligations of the former Scout holders of capital stock.

The Company may be subject to litigation or other claims in the normal course of business. In the opinion of management, the Company’s ultimate liability, if any, related to any currently pending or threatened litigation or claims is remote, not reasonable possibly or not probable of loss and would not materially affect its consolidated financial position, results of operations or cash flows

## 11. Stockholders’ Equity

## Stock Option Plans

The Company maintains the following stock plans: the 2011 Equity Incentive Plan (the “2011 Plan”) and the 2011 Employee Stock Purchase Plan. The Company’s board of directors, by delegation to its compensation committee, administers the 2011 Plan and has authority to determine the directors, officers, employees and consultants to whom options, restricted stock units or restricted stock awards may be granted, the option price or restricted stock purchase price, the timing of when each share is exercisable and the duration of the exercise period and the nature of any restrictions or vesting periods applicable to an option or restricted stock grant

Under the 2011 Plan, options granted are generally subject to a four-year vesting period whereby 25% of the options become vested after a one-year period and the remainder then vests monthly through the end of the vesting period. Vested options may be exercised up to ten years from the grant date, as defined in the 2011 Plan. Vested but unexercised options expire three months after termination of employment with the Company. The restricted stock units and awards typically vest over four years with annual vesting as to one-fourth of the grant on each anniversary date with vesting contingent upon employment with the Company.

The Company has elected to recognize the compensation cost of all stock-based awards on a straight-line basis over the vesting period of the award. Further, the Company applied an estimated forfeiture rate to unvested awards when computing the share compensation expenses. The Company estimated the forfeiture rate for unvested awards based on

its historical experience on employee turnover behavior and other factors.

At the end of each fiscal year, the share reserve under the 2011 Plan increases automatically by an amount equal to 4% of the outstanding shares as of the end of that most recently completed fiscal year or 3,840,000 shares, whichever is less. On January 1, 2013, 3.0 million additional shares were reserved under the 2011 Equity Incentive Plan pursuant to the automatic increase.

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## Stock Option Exchange Program

On December 21, 2012, the Company launched a stock option exchange program (the “Offer”) pursuant to which eligible employees were able to exchange certain outstanding out-of-the money stock options with an exercise price greater than \$6.03 per share for a lesser amount of new stock options. The Offer expired on January 22, 2013. As a result of the Offer, options to purchase an aggregate of 2.8 million shares of the Company’s common stock were accepted for exchange (representing approximately 80% of the total options eligible for exchange). All surrendered options were cancelled effective as of the expiration of the Offer, and in exchange for those options, the Company issued a total of approximately 1.0 million new stock options. The exercise price per share of each new option granted pursuant to the Offer was \$6.03 per share, the closing price of the Company’s common stock on January 22, 2013. The new stock options have the same vesting schedules as the options tendered for exchange and the new options are not exercisable for a one-year period from the Offer’s expiration date. The Offer did not result in any significant incremental stock-based compensation expense.

## Determining Fair Value of Stock Options

The estimated fair value of stock options and awards granted during 2013, 2012 and 2011, was approximately \$29.3 million, \$41.7 million and \$27.1 million, respectively. The Company estimates the fair value of stock option awards at the date of grant using the Black-Scholes option-pricing model. 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 estimated forfeitures on a straight-line basis over the requisite service period of the options, which is generally four years. Restricted stock vest over four years and upon vesting, entitles the holder to one share of common stock for each restricted stock and has an exercise price of \$0.0001 per share, which is equal to the par value of the Company’s common stock. 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 estimated forfeitures, is recognized on a straight-line basis over the vesting period.

The fair value of each grant of options during 2013, 2012 and 2011 was determined by the Company using the methods and assumptions discussed below. The Company stratifies its population of outstanding share options into two relatively homogeneous groups to estimate the expected term and forfeiture rate of options grants. Each of these inputs is subjective and generally requires significant judgment to determine.

**Expected Term**—The expected term represents the period that the Company’s share-based awards are expected to be outstanding. The Company calculated the expected term of share options using four data points: options exercised, options expired, options forfeited and options outstanding. The weighted-average of the four data points were used to calculate the expected term.

**Expected Volatility**—The expected volatility was based on the historical stock volatility of several of the Company’s self-designated publicly listed comparable companies over a period equal to the expected terms of the options, as the Company has limited trading history to use the volatility of its own common shares.

**Risk-Free Interest Rate**—The risk-free interest rate was based on the implied yield on U.S. Treasury zero-coupon issues for each option grant date with maturities approximately equal to the option’s contractual term.

**Expected Dividend Yield**—The Company has not paid dividends on its common shares nor does it expect to pay dividends in the foreseeable future.

**Forfeiture Rate**—The Company estimated its forfeiture rate based on an analysis of its actual forfeitures and will continue to evaluate the adequacy of the forfeiture rate based on actual forfeiture experience, analysis of employee turnover behavior, and other factors. The impact from a forfeiture-rate adjustment will be recognized in full in the period of adjustment, if the actual number of future forfeitures differs from that estimated by the Company.

The weighted average Black-Scholes option-pricing model assumptions for years ended 2013, 2012 and 2011 were as follows:

	Years Ended December 31,			
	2013	2012	2011	
Expected term (in years)	5.00	5.05	5.26	
Expected volatility	43	% 46	% 50	%



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Risk-free interest rate	1.19	%	0.76	%	1.5	%
Expected dividend yield	—	%	—	%	—	%

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## 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 six-month offering period.

The Company estimates the fair value of purchase rights under the ESPP using the Black-Scholes option-pricing model. The fair value of each purchase right under the ESPP was estimated on the date of grant using the Black-Scholes option valuation model and the straight-line attribution approach with the following weighted-average assumptions:

	Years Ended December 31,		
	2013	2012	2011
Expected term (in years)	0.5 -1.0	0.50	0.39-0.50
Expected volatility	27	% 45	% 36%-45%
Risk-free interest rate	0.13%-0.17%	0.14	% 0.18%-0.07%
Expected dividend yield	—	% —	% —

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. As of December 31, 2013, 686,957 shares had been issued under the ESPP and 1,695,089 shares were available for future issuance.

## Stock Awards Issued to Non Employees

During 2011, the Company granted stock options to purchase 10,000 common shares, to non employees for professional services at exercise prices of \$6.20 per share. There were no stock awards issued to non employees in 2013 and 2012. Stock-based compensation expense related to options granted to non employees was \$0.1 million during 2011.

Option and RSU activity under the Option Plans for 2013, 2012 and 2011 was as follows (shares and aggregate intrinsic value in thousands):

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	Shares Available for Grant	Options Outstanding Number of Shares	Weighted-Average Exercise Price	Restricted Stock Outstanding Number of Shares
Outstanding—January 1, 2011	2,872	17,723	\$4.32	—
Additional shares reserved under the 2011 Equity Incentive Plan	5,760	—	—	—
Granted	(2,996)	) 2,186	13.44	810
Exercised	—	(3,808)	) 3.75	—
Forfeited	774	(766)	) 5.58	(8)
Outstanding—December 31, 2011	6,410	15,335	5.70	802
Additional shares reserved under the 2011 Equity Incentive Plan	2,903	—	—	—
Granted	(6,523)	) 2,954	12.30	3,569
Options exercised/ Restricted stock released	—	(2,100)	) 3.84	(209)
Forfeited	1,234	(1,000)	) 9.57	(234)
Outstanding—December 31, 2012	4,024	15,189	6.98	3,928
Additional shares reserved under the 2011 equity incentive plan	3,025	—	—	—
Granted	(6,565)	) 3,023	7.43	3,542
Options exercised/ Restricted stock released	—	(5,147)	) 4.47	(920)
Canceled/Forfeited	5,271	(4,157)	) 12.77	(1,119)
Outstanding — December 31, 2013	5,755	8,908	5.89	5,431
	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Options vested and expected to vest—December 31, 2013	8,454	\$5.80	6.16	\$23,764
Options exercisable—December 31, 2013	5,440	4.98	4.96	19,082
Restricted stock expected to vest- December 31, 2013	4,159	—	1.59	34,856

The weighted-average grant date fair value of options granted during 2013, 2012 and 2011 was \$3.18, \$4.98 and \$6.53, respectively. The weighted average grant date fair values of restricted stock units granted during 2013, 2012 and 2011 was \$8.26, \$11.69 and \$15.92, respectively.

The aggregate intrinsic value of options exercised under the Option Plans was \$23.9 million, \$21.9 million and \$42.2 million, in 2013, 2012 and 2011, respectively, determined as of the date of option exercise. The intrinsic value is calculated as the difference between the fair value of the common shares on the exercise date and the exercise price of the option shares. The total estimated fair value of share options vested in 2013, 2012 and 2011 was \$15.9 million, \$13.1 million and \$11.4 million, respectively.

Stock-based compensation expense is based on applying estimated fair values determined at the grant date to those options granted in the year that are ultimately expected to vest. Accordingly, the fair values calculated on the total population of grants have been reduced for estimated forfeitures expected to occur in the future.

The table below summarizes stock-based compensation expense as allocated within the Company's consolidated statements of operations (in thousands):

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	Years Ended December 31,		
	2013	2012	2011
	(in thousands)		
Includes stock-based compensation of:			
Cost of revenue	\$3,303	\$2,772	\$1,877
Sales and marketing	9,831	8,146	4,456
Research and development	2,414	1,880	1,167
General and administrative	8,072	8,077	4,099
Total stock-based compensation	\$23,620	\$20,875	\$11,599

The following table summarizes information about stock options outstanding at December 31, 2013 (shares in thousands):

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number of Shares Outstanding	Weighted-Average Remaining Contract Life (in Years)	Weighted-Average Exercise Price per Share	Number of Shares Exercisable	Weighted-Average Exercise Price
\$0.20 to \$1.49	90	1.90	\$0.97	90	\$0.97
\$4.26	2,263	3.32	4.26	2,263	4.26
\$4.60 to \$5.10	1,804	6.37	4.74	1,524	4.69
\$5.80 to \$6.03	2,338	6.31	5.89	1,297	5.88
\$6.20 to \$17.98	2,413	9.16	8.45	266	9.84
	8,908	6.29	5.89	5,440	4.98

As of December 31, 2013 and 2012 there was \$49.5 million and \$55.6 million of unrecognized compensation expense related to nonvested share-based compensation arrangements granted under the 2011 Plan, which is expected to be recognized over a weighted-average period of 2.83 years and 2.49 years, respectively.

## 12. Employee Benefit Plan

The Company maintains a 401(k) defined contribution benefit plan that covers domestic employees who have attained 21 years of age and provide at least 20 hours of service per week. This plan allows U.S. employees to contribute up to 90% of their pre-tax salary in certain investments at the discretion of the employee, up to maximum annual contribution limits established by the U.S. Department of Treasury. During 2013, 2012 and 2011, the Company matched up to 50% of employee contributions up to an annual limit of \$2,000. Matching contributions by the Company are fully vested upon completion of the first year of employment. Employer matching contributions, which may be discontinued at the Company's discretion, amounted to \$1.3 million, \$1.1 million and \$1.0 million, during 2013, 2012 and 2011, respectively.

## 13. Income Taxes

Loss from continuing operations before provision for (benefit from) income taxes for the Company's domestic and international operations was as follows (in thousands):

	Years Ended December 31,		
	2013	2012	2011
Domestic	\$(20,124)	) \$(10,381)	) \$(3,664)
International	(1,857)	) (326)	) (608)
Loss before provision for income taxes	\$(21,981)	) \$(10,707)	) \$(4,272)

The income tax provision (benefit) consisted of the following (in thousands):

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	Years Ended December 31,		
	2013	2012	2011
Current:			
Federal	\$—	\$(489	) \$1,116
Foreign	501	1,112	424
State and local	153	144	98
Total current income tax provision	654	767	1,638
Deferred:			
Federal	—	25,779	(16,756
Foreign	(90	) 76	56
State and local	307	5,485	(4,321
Total deferred income tax provision (benefit)	217	31,340	(21,021
Income tax provision (benefit)	\$871	\$32,107	\$(19,383

The following table provides a reconciliation of income taxes provided at the federal statutory rate of 34% to the income tax provision (benefit) (in thousands):

	Years Ended December 31,		
	2013	2012	2011
U.S. income tax at federal statutory rate	\$(7,464	) \$(3,640	) \$(1,452
Provision from (income) loss attributable to LLC (through February 28, 2011)	—	—	1,470
Benefit from change in tax status	—	—	(20,740
State income taxes, net of federal benefit	544	391	52
Foreign tax rate differential	1,000	674	415
Permanent differences	231	364	876
State tax credits	(1,824	) (1,040	) (228
Valuation allowance	8,366	35,690	196
Other, net	18	(332	) 28
Income tax provision (benefit)	\$871	\$32,107	\$(19,383

Effective March 1, 2011, the parent company elected to be treated as a corporation under Subchapter C of Chapter 1 of the United States Internal Revenue Code, and therefore became subject to federal and state tax expense beginning March 1, 2011. As a result of this tax election, the Company recorded a net deferred tax asset and a one-time non-cash tax benefit of \$20.7 million. On March 24, 2011, the LLC converted into a Delaware corporation and merged with two of its corporate equity holders. The Company recorded an additional deferred tax asset of \$8.1 million and a corresponding adjustment to paid-in capital as a result of the merger.

In December 2013, Malaysia granted a ten year tax holiday to the Company's Malaysia subsidiary, commencing with its fiscal year beginning January 1, 2014. This resulted in a tax benefit in fiscal 2013 of approximately \$0.2 million from the elimination of the Malaysia subsidiary's deferred tax liabilities. The earnings per share benefit in 2013 is less than \$0.01.

The following table provides the effect of temporary differences that created deferred income taxes as of December 31, 2013 and 2012. Deferred tax assets and (liabilities) represent the future effects on income taxes resulting from temporary differences and carryforwards at the end of the respective periods (in thousands):

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	December 31, 2013	2012	
Current			
Accrued liabilities	\$4,157	\$3,580	
State taxes	—	—	
Allowance for doubtful accounts	32	99	
Current deferred tax assets	4,189	3,679	
Non-current			
Share-based compensation expense	13,126	12,261	
Net operating loss carryforwards	16,452	9,324	
State tax credits	4,634	2,487	
Unrealized loss on foreign exchange transactions	—	266	
Amortization of tax intangibles	9,486	11,751	
Other, net	194	(1,805)	)
Non-current deferred tax assets	43,892	34,284	
Total current and non-current	48,081	37,963	
Deferred tax liabilities			
Property & equipment	(1,204	) (203	)
Convertible debt costs	(2,571	) —	
Gross deferred tax assets	44,306	37,760	
Less: Valuation allowance	(42,155	) (35,392	)
Net deferred tax assets	\$2,151	\$2,368	

As of December 31, 2013 and 2012, management assessed the realizability of deferred tax assets. Management evaluated the need for and amount of any valuation allowance for 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. In concluding on the evaluation, management placed significant emphasis on guidance in ASC 740, which states that “[a] cumulative loss in recent years is a significant piece of negative evidence that is difficult to overcome.” Based upon available evidence, it was concluded on a more-likely-than-not basis that most of our U.S. deferred tax assets were not realizable as of December 31, 2013. Significant negative evidence included U.S. pretax losses (as calculated consistent with ASC 740) in each of the Company’s 2013 quarters and for the cumulative twelve-quarter period ended December 31, 2013. Additionally, company forecasts indicated a continuation of U.S adjusted pretax losses for calendar 2013. Management also concluded on a more-likely-than-not basis that our Singapore and Ireland deferred tax assets were not realizable, using the analysis prescribed in ASC 740. Other factors were considered but provided neither positive nor negative objectively-verifiable evidence as to the realization of our deferred tax assets. The remaining deferred tax assets at December 31, 2013 relate to jurisdictions in which we have net adjusted historical pretax profits and sufficient forecast profitability to assure future realization of such deferred tax assets. In 2012, management determined that it was not more likely than not that the deferred tax assets will be realized with respect to US federal and state deferred tax assets, except for certain US state deferred tax assets where the Company’s subsidiary has profitable operations. A valuation allowance was also provided in 2012 with respect to net operating loss carryforwards in Singapore and Japan.

The net change in the valuation allowance for the years ended December 31, 2013 and 2012 was an increase of \$6.8 million and \$35.2 million, respectively.

As of December 31, 2013, the Company had net operating loss carryforwards of approximately \$91.8 million for federal income tax purposes and approximately \$66.2 million for California income tax purposes. These losses are



available to reduce taxable income and expire at various dates beginning in 2016. Approximately \$50 million of federal net operating loss carryforwards and \$35.2 million of California net operating loss carryforwards are related to excess tax benefits from stock-based compensation. The tax benefits associated with net operating losses attributed to stock-based compensation will be

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credited to additional paid-in capital when realized. The Company uses a “with and without” approach to determine the utilization of excess tax benefits from stock-based compensation. The Company considers only the direct impact of stock option awards when calculating the amount of windfalls or shortfalls attributable to stock-based compensation. At December 31, 2013, the Company had \$2.4 million of US federal research and development credits which expire beginning in 2031, and \$2.6 million of California research and development credits which do not expire. The Company also has \$0.2 million of California Enterprise Zone Credits which expire beginning in 2024 if not utilized, and \$1.9 million of other state tax credits which expire beginning in 2024 if not utilized.

Utilization of the Company’s net operating loss and tax credit carryforwards may be subject to a substantial annual limitation due to the ownership change limitations provided by the Internal Revenue Code and similar state provisions. Such an annual limitation could result in the expiration or elimination of the net operating loss and tax credit carryforwards before utilization. In connection with the conversion of the LLC into a Delaware corporation, two of its equity holders, GA SS Holdings LLC and SLLC Holdings, Inc were merged with and into ServiceSource International, Inc. As a result, the Company acquired the net operating loss carryforwards of these two entities subject to the ownership change limitations. Management believes that the limitation will not limit utilization of the carryforwards prior to their expiration.

The Company’s income taxes payable has been adjusted for the tax benefits associated with employee stock option transactions. These adjustments to stockholders’ equity amounted to \$0.4 million debit and \$1.5 million credit for the years ended December 31, 2013 and 2012, respectively.

The Company files U.S. federal and state and foreign income tax returns in jurisdictions with varying statutes of limitations. In the normal course of business the Company is subject to examination by taxing authorities throughout the world. These audits could include examining the timing and amount of deductions, the allocation of income among various tax jurisdictions and compliance with federal, state, local and foreign tax laws. The Company is currently under audit by the state of California for its 2008 through 2010 tax years. The 2008 through 2013 tax years generally remain subject to examination by federal, state and foreign tax authorities.

The Company has implemented the provisions of ASC 740-10, Accounting for Uncertainty in Income Taxes. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

Balance as of December 31, 2012	\$433
Additions based on tax positions related to the current year	317
Additions for tax positions of prior years	130
Reductions for tax positions of prior years	—
Balance as of December 31, 2013	\$880

At December 31, 2013, the Company had a liability for unrecognized tax benefits of \$0.9 million, \$51,000 of which, if recognized, would affect the company’s effective tax rate. The Company does not expect its unrecognized tax benefits to change significantly over the next 12 months.

The Company recognizes interest and penalties accrued related to unrecognized tax benefits in income tax expense. During the year ended December 31, 2013, the Company recognized and accrued approximately \$2,000 of interest. During the years ended December 31, 2012 and 2011, the Company recognized \$3,000 and zero, respectively, of interest or penalties related to unrecognized tax

The Company considers its undistributed earnings of its foreign subsidiaries indefinitely reinvested in foreign operations and has not provided for U.S. income taxes on such earnings. As of December 31, 2013 the Company’s unremitted earnings from its foreign subsidiaries was \$3.2 million. The determination of the unrecognized deferred U.S. income tax liability, if any, is not practicable due to the complexities associated with its hypothetical calculation.

#### 14. Reportable Segments

The Company’s operations are principally managed on a geographic basis and are comprised of three reportable and operating segments: NALA, EMEA, and APJ, as defined below.

The Company reports segment information based on the management approach. The management approach designates the internal reporting used by the Company's Chief Operating Decision Maker ("CODM"), for making decisions and assessing performance as the source of the Company's reportable segments. The CODM is the Company's Chief Executive Officer. The CODM allocates resources to and assesses the performance of each of the operating segment using information about its

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revenue and direct profit contribution, which is management's measure of segment profitability. Management has determined that the Company's reportable and operating segments are as follows, based on the information used by the CODM:

NALA—Includes operations from offices in San Francisco, California; Denver, Colorado and Nashville, Tennessee related primarily to end customers in North America.

EMEA—Includes operations from offices in Liverpool, United Kingdom and Dublin, Ireland related primarily to end customers in Europe.

APJ—Includes operations from offices in Kuala Lumpur, Malaysia and Singapore related primarily to end customers in Asia Pacific and Japan.

The Company does not allocate sales and marketing, research and development, or general and administrative expenses to its geographic regions because management does not include the information in its measurement of the performance of the operating segments. The Company excludes certain items such as stock-based compensation, overhead allocations and other items from direct profit contribution. Revenue for a particular geography reflects fees the Company earns from its customers for sales and renewals of maintenance, support and subscription contracts on their behalf and managed from the Company's sales center in that geography.

As the Company continues to shift its business from managed services to a subscription model with its technology platform, both organically and through acquisition, it expects cloud and data services to represent an increasing percentage of its revenue. The Company expects to present two operating segments consisting of managed services and cloud and data services beginning in the first quarter of 2014 as relevant financial information will be prepared for each of the two operating segments that will be used by the chief operating decision maker to allocate resources among the two segments and to evaluate the financial performance of the two segments.

Summarized financial information by geographic location for 2013, 2012 and 2011 based on the Company's internal management reporting and as utilized by the Company's CODM, is as follows (in thousands):

	Years Ended December 31,		
	2013	2012	2011
Net revenue			
NALA	\$ 173,188	\$ 150,041	\$ 127,430
EMEA	73,839	66,902	58,344
APJ	25,455	26,760	19,727
Total net revenue	\$ 272,482	\$ 243,703	\$ 205,501
Direct profit contribution			
NALA	90,302	80,153	72,333
EMEA	39,040	35,517	27,756
APJ	7,711	7,117	1,945
Total direct profit contribution	137,053	122,787	102,034
Adjustments:			
Stock-based compensation	(3,303	) (2,772	) (1,877
Overhead allocations and other, net	(23,717	) (12,633	) (8,062
Gross Profit	\$ 110,033	\$ 107,382	\$ 92,095

The majority of the Company's assets at December 31, 2013 and 2012 were attributable to its U.S. operations. Property and equipment information is based on the physical location of the assets. The following table presents the long-lived assets, consisting of property and equipment, by geographic location (in thousands):

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	December 31,	
	2013	2012
NALA	\$22,976	\$29,783
EMEA	1,614	1,120
APJ	3,408	3,610
Total property and equipment, net	\$27,998	\$34,513

Additions to long-lived assets in 2013 were \$2.9 million, \$1.3 million and \$1.3 million in NALA, EMEA and APJ, respectively. In 2012, additions to long-lived assets including internally-developed software were \$22.7 million, \$0.3 million and \$2.1 million in NALA, EMEA and APJ, respectively.

## 15. Selected Quarterly Financial Data (Unaudited)

Selected summarized quarterly financial information for the years ended December 31, 2013 and 2012 is as follows:

	Three Months Ended							
	Dec. 31, 2013	Sep. 30, 2013	Jun. 30, 2013	Mar. 31, 2013	Dec. 31, 2012	Sep. 30, 2012	Jun. 30, 2012	Mar. 31, 2012
	(in thousands, except per share amounts)							
Net revenue	\$77,182	\$66,482	\$67,697	\$61,121	\$67,345	\$59,090	\$59,694	\$57,574
Gross profit	31,581	26,752	29,077	22,623	32,026	24,546	25,812	24,998
Loss from operations	384	3,656	3,867	9,655	197	3,382	3,219	3,135
Loss before provision for income taxes	3,307	4,749	4,162	9,762	667	3,262	3,552	3,226
Net loss <sup>(1)</sup>	\$1,988	\$5,502	\$4,906	\$10,455	\$1,185	\$3,584	\$36,769	\$1,276
Net loss per common share:								
Basic and diluted	\$0.02	\$0.07	\$0.06	\$0.14	\$0.02	\$0.05	\$0.50	\$0.02

(1) The three months ended June 30, 2012 includes the effect of providing a valuation allowance of \$33.1 million for a substantial portion of the Company's deferred tax assets.

## 16. Related Party Transactions

Richard Campione was elected to the Company's Board of Directors (the "Board") on November 29, 2012. On December 19, 2012, the Company entered into a consulting agreement with Mr. Campione under which Mr. Campione provides certain software consulting services to the Company. The Audit Committee of the Board pre-approved this consulting agreement in accordance with the Company's formal policy regarding related party transactions. The Company paid Mr. Campione \$0.3 million for consulting services provided during the term of the agreement, which ended April 30, 2013.

## 17. Subsequent Events

On January 22, 2014, the Company acquired Scout Analytics, Inc., a leading provider of predictive analytics for subscription businesses, which will become a wholly owned subsidiary of the Company. The total purchase consideration was \$32.8 million net of debt, paid in cash. The Company is currently completing the preliminary purchase price allocation and expects the majority of the purchase consideration to be allocated to intangible assets and goodwill.



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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

(a) Evaluation of disclosure controls and procedures

Under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as of the end of the period covered by this Annual Report on Form 10-K.

In designing and evaluating our disclosure controls and procedures, management recognizes that any disclosure controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Based on management's evaluation, our chief executive officer and chief financial officer concluded that as of December 31, 2013 our disclosure controls and procedures are designed to, and are effective to, provide at a reasonable assurance level that the information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosures.

(b) Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2013 based on the guidelines established in Internal Control—Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles.

Based on the results of our evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2013. The effectiveness of our internal control over financial reporting as of December 31, 2013 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in its report which is included in Item 8 of this Annual Report on Form 10-K.

(c) Changes in internal control over financial reporting

There was no change in our internal control over financial reporting that occurred during the quarter ended December 31, 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

(d) Inherent Limitations on Effectiveness of Controls

Our management, including our chief executive officer and chief financial officer, do not expect that our disclosure controls or our internal control over financial reporting will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally,

controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because

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of changes in conditions, or the degree of compliance with policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

ITEM 9B. OTHER INFORMATION

Not applicable.

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**PART III**

**ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The information required by Item 10 of this Annual Report on Form 10-K that is found in our 2013 Definitive Proxy Statement to be filed with the SEC in connection with the solicitation of proxies for our 2013 Annual Meeting of Stockholders (“2013 Proxy Statement”) is incorporated herein by reference to our 2013 Proxy Statement. The 2013 Proxy Statement will be filed with the SEC within 120 days after the end of the fiscal year to which this report relates. We have adopted a Code of Business Conduct and Ethics for all officers, directors and employees. We have posted the Code of Business Conduct and Ethics on our website <http://www.servicesource.com>. We intend to satisfy the disclosure requirement under Item 5.05 of Form 8-K regarding an amendment to, or a waiver from, this Code of Business Conduct and Ethics by posting such information on our website.

**ITEM 11. EXECUTIVE COMPENSATION**

The information required by Item 11 of this Annual Report on Form 10-K that is found in our 2013 Proxy Statement is incorporated herein by reference to our 2013 Proxy Statement. The 2013 Proxy Statement will be filed with the SEC within 120 days after the end of the fiscal year to which this report relates.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information required by Item 12 of this Annual Report on Form 10-K that is found in our 2013 Proxy Statement is incorporated herein by reference to our 2013 Proxy Statement. The 2013 Proxy Statement will be filed with the SEC within 120 days after the end of the fiscal year to which this report relates.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

The information required by Item 13 of this Annual Report on Form 10-K that is found in our 2013 Proxy Statement is incorporated herein by reference to our 2013 Proxy Statement. The 2013 Proxy Statement will be filed with the SEC within 120 days after the end of the fiscal year to which this report relates.

**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information required by Item 14 of this Annual Report on Form 10-K that is found in our 2013 Proxy Statement is incorporated herein by reference to our 2013 Proxy Statement. The 2013 Proxy Statement will be filed with the SEC within 120 days after the end of the fiscal year to which this report relates.

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PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) (1) All financial statements

Consolidated financial statements filed as part of this report are listed under Part II, Item 8, pages [26] through [41] of this Form 10-K.

(2) Financial Statement Schedules

No schedules are required because either the required information is not present or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the consolidated financial statements or the notes thereto.

(3) Exhibits

See Item 15(b) below. Each management contract and compensatory plan or arrangement required to be filed has been identified.

(b) Exhibits

The exhibits listed on the accompanying Exhibit Index immediately following the signature page are filed as part of, or are incorporated by reference into, this Annual Report on Form 10-K.

(c) Financial Statement Schedules

Reference is made to Item 15(a)(2) above.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SERVICESOURCE INTERNATIONAL, INC.

Dated: March 7, 2014 By: /s/ MICHAEL A. SMERKLO  
 Michael A. Smerklo  
 Chairman of the Board and Chief Executive Officer  
 (Principal Executive Officer)

SERVICESOURCE INTERNATIONAL, INC.

Dated: March 7, 2014 By: /s/ ASHLEY F. JOHNSON  
 Ashley F. Johnson  
 Chief Financial Officer  
 (Principal Financial and Accounting Officer)

**POWER OF ATTORNEY**

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below hereby constitutes and appoints Michael A. Smerklo, Ashley F. Johnson and Matthew Goldberg, and each of them, his or her true and lawful attorney-in-fact and agent, with full power of substitution, each with power to act alone, to sign and execute on behalf of the undersigned any and all amendments to this Annual Report on Form 10-K, and to perform any acts necessary in order to file the same, with all exhibits thereto and other documents in connection therewith with the Securities and Exchange Commission, granting unto said attorney-in-fact and agent full power and authority to do and perform each and every act and thing requested and necessary to be done in connection therewith, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorney-in-fact and agent, or their or his or her substitutes, shall do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the ServiceSource International, Inc. and in the capacities and on the dates indicated.

Date	Signature	Title
March 7, 2014	/s/ MICHAEL A. SMERKLO Michael A. Smerklo	Chairman of the Board and Chief Executive Officer (Principal Executive Officer)
March 7, 2014	/s/ ASHLEY F. JOHNSON Ashley F. Johnson	Chief Financial Officer (Principal Financial and Accounting Officer)
March 7, 2014	/s/ ROBERT G. ASHE Robert G. Ashe	Director
March 7, 2014	/s/ STEVEN M. CAKEBREAD Steven M. Cakebread	Director
March 7, 2014	/s/ RICHARD J. CAMPIONE Richard J. Campione	Director

March 7, 2014

/s/ BRUCE W. DUNLEVIE  
Bruce W. Dunlevie

Director

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Date	Signature	Title
March 7, 2014	/s/ JAMES C. MADDEN James C. Madden	Director
March 7, 2014	/s/ MARK F. MCMORRIS Mark F. McMorris	Director
March 7, 2014	/s/ THOMAS F. MENDOZA Thomas F. Mendoza	Director
March 7, 2014	/s/ BARRY D. REYNOLDS Barry D. Reynolds	Director

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## Index to Exhibits

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference Herein		
			Exhibit	Form/File No.	Filing Date
2.1	Form of Conversion Agreement dated as of March 24, 2011, between the Registrant, GA SS Holding LLC and SLLC Holdings, Inc.		2.1	Form S-1/A (No. 333-171271)	March 11, 2011
2.2	Form of Agreement and Plan of Merger dated as of March 24, 2011, between the Registrant, GA SS Holding LLC, GA SS Holding II, LLC, SLLC Holdings, Inc. and Benchmark Capital Partners V, L.P.		2.2	Form S-1/A (No. 333-171271)	March 11, 2011
3.1	Certificate of Incorporation of the Company filed March 24, 2011		3.1	Form 8-K (No. 001-35108)	April 1, 2011
3.2	Bylaws of the Company dated March 24, 2011		3.2	Form 8-K (No. 001-35108)	April 1, 2011
3.3	Fifth Amended and Restated Limited Liability Company Agreement		3.3	Form S-1/A (No. 333-171271)	January 28, 2011
4.1	Registration and Information Rights Agreement dated as of December 8, 2006, between the Registrant and GA SS Holding LLC, SLLC Holdings, Inc., Housatonic Micro Fund SBIC, LP and Housatonic Equity Investors SBIC, LP		4.1	Form S-1/A (No. 333-171271)	February 25, 2011
4.2	Securities Purchase Agreement and Registration Rights Schedule dated as of January 31, 2003, between the Registrant and the 2003 Holders		4.2	Form S-1/A (No. 333-171271)	February 25, 2011
4.3	Specimen common stock certificate of the Registrant		4.3	Form S-1/A (No. 333-171271)	March 11, 2011
4.4	Indenture between ServiceSource International, Inc. and Wells Fargo Bank, National Association, dated as of August 13, 2013		4.4	Form 8-K (No. 001-35108)	August 14, 2013
10.1	Credit Agreement dated as of July 5, 2012 between the Company and JPMorgan Chase Bank, National Association		10.1	Form 10-Q (No. 001-35108)	November 9, 2012
10.2	Pledge and Security Agreement entered into as of July 5, 2012 by and		10.1	Form 10-Q (No. 001-	August 3, 2012

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between ServiceSource International,  
Inc. , ServiceSource Delaware Inc and  
JPMorgan Chase Bank, N.A.

35108)

10.3+	Form of Director and Executive Officer Indemnification Agreement	10.1	Form S-1 (No. 333- 171271)	December 20, 2010
10.4+	2004 Omnibus Share Plan and forms of agreements thereunder	10.2	Form S-1 (No. 333- 171271)	December 20, 2010

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Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference Herein		
			Exhibit	Form/File No.	Filing Date
10.5+	2008 Share Option Plan and form of agreement thereunder		10.3	Form S-1 (No. 333-171271)	December 20, 2010
10.6+	2011 Equity Incentive Plan and forms of agreements thereunder		4.4	Form S-8 (No. 333-173116)	March 28, 2011
10.7+	2011 Equity Incentive Plan form of Restricted Stock Award Agreement		10.1	Form 8-K (No. 001-35108)	February 10, 2012
10.8+	2011 Employee Stock Purchase Plan and form of agreement thereunder		4.5	Form S-8 (No. 333-173116)	March 28, 2011
10.9+	Amended and Restated Employment and Confidential Information Agreement dated as of June 8, 2010, between the Registrant and Michael A. Smerklo		10.5	Form S-1 (No. 333-171271)	December 20, 2010
10.10+	Amended and Restated Employment and Confidential Information Agreement dated as of December 8, 2010, between the Registrant and Jeffrey M. Bizzack		10.6	Form S-1 (No. 333-171271)	December 20, 2010
10.11+	Amended and Restated Employment and Confidential Information Agreement dated as of July 7, 2010, between the Registrant and David Oppenheimer		10.7	Form S-1 (No. 333-171271)	December 20, 2010
10.12+	Amended and Restated Employment and Confidential Information Agreement dated as of December 8, 2010, between the Registrant and Robert Sturgeon		10.8	Form S-1 (No. 333-171271)	December 20, 2010
10.13+	Amended and Restated Employment and Confidential Information Agreement dated as of December 8, 2010, between the Registrant and Raymond M. Martinelli		10.10	Form S-1 (No. 333-171271)	December 20, 2010
10.14+	Amended and Restated Employment Letter Agreement dated as of November 4, 2010, between the Registrant and Natalie A. McCullough		10.11	Form S-1 (No. 333-171271)	December 20, 2010
10.15+	Amended and Restated Employment and Confidential Information Agreement dated as of		10.12	Form S-1/A (No. 333-171271)	January 28, 2011

10.18+	December 8, 2010, between the Registrant and Paul D. Warenski Employment and Confidential Information Agreement dated as of August 16, 2011, between the Company and John Boucher Amended and Restated	10.1	Form10-Q (No. 001-35108)	November 14, 2011
10.19+	Employment and confidential Information Agreement dated as of December 6, 2010, between the Registrant and Jay Ackerman	10.18	Form10-K (No. 001-35108)	March 6, 2012

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Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference Herein		
			Exhibit	Form/File No.	Filing Date
10.23	Office Lease, dated as of October 31, 2007, between the Registrant and Six Thirty-Four Second Street, LLC		10.16	Form S-1/A (No. 333-171271)	February 25, 2011
10.24	Amendment No. 2, dated August 6, 2013, to the Credit Agreement between ServiceSource International, Inc. and JPMorgan Chase Bank, N.A.		10.1	Form 8-K (No. 001-35108)	August 9, 2013
10.25	Form of Convertible Note Hedge Confirmation		10.3	Form 8-K (No. 001-35108)	August 9, 2013
10.26	Form of Warrant Confirmation		10.4	Form 8-K (No. 001-35108)	August 9, 2013
21.1	List of subsidiaries	X			
23.1	Consent of PricewaterhouseCoopers LLP	X			
31.1	Certification of Principal Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	X			
31.2	Certification of Principal Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	X			
32.1*	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	X			
32.2*	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	X			
101.INS**	XBRL Instance Document				
101.SCH**	XBRL Taxonomy Extension Schema				
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase				
101.DEF**	XBRL Taxonomy Extension Definition Linkbase				

101.LAB\*\* XBRL Taxonomy Extension Label  
Linkbase

101.PRE\*\* XBRL Taxonomy Extension  
Presentation Linkbase

+ Management contract or compensatory plan or arrangement.

In accordance with Item 601(b)(32)(ii) of Regulation S-K and SEC Release No. 33-8238 and 34-47986, Final Rule: Management's Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, the certifications furnished in Exhibits 32.1 and 32.2 hereto are deemed to

\* accompany this Annual Report on Form 10-K and will not be deemed "filed" for purposes of Section 18 of the Exchange Act. Such certifications will not be deemed to be incorporated by reference into any filings under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

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\*\* XBRL (Extensible Business Reporting Language) information is furnished and not filed herewith, is not a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

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