



Qualys Q2 FY2020 Earnings Prepared Remarks

Foster City, Calif., – August 10, 2020 – [Qualys, Inc.](#) (NASDAQ: QLYS), a pioneer and leading provider of disruptive cloud-based IT, security and compliance solutions, today announced financial results for the second quarter ended June 30, 2020.

Vinayak Rao, Investor Relations

Good afternoon and welcome to Qualys' second quarter 2020 earnings call.

Joining me today to discuss our results are Philippe Courtot, our chairman and CEO, and Joo Mi Kim, our CFO. Before we get started, I would like to remind you that our remarks today will include forward-looking statements that generally relate to future events or our future financial or operating performance. Actual results may differ materially from these statements. Factors that could cause results to differ materially are set forth in today's press release and in our filings with the SEC, including our latest Form 10-Q and 10-K. Any forward-looking statements that we make on this call are based on assumptions as of today, and we undertake no obligation to update these statements as a result of new information or future events.

During this call we will present both GAAP and non-GAAP financial measures. A reconciliation of GAAP to non-GAAP measures is included in today's earnings press release. As a reminder, the press release, prepared remarks, investor presentation, and supplemental historical financial spreadsheet are available on our website. With that, I'd like to turn the call over to Philippe.

Philippe Courtot, Chairman and CEO

Thank you and welcome everyone to our Q2 earnings call. We hope that you and your families are healthy and safe. Our priorities remain the health and well-being of our employees, while continuing to address and support the changing security needs of our customers. Since mid-March, we have seen a seamless transition to a remote work environment and have continued to effectively deliver on all aspects of our business, including product development, operations and support services.

The unprecedented environment with the ongoing COVID-19 pandemic has created uncertainty for individuals and organizations across the globe. As companies are experiencing a never-before-seen explosion of remote endpoints connecting to critical assets of their organizations, security of these endpoints is paramount. IT teams are responding to the challenge of ensuring that employees are able to work productively and securely from remote locations and it is

becoming eminently clear that traditional enterprise security solutions deployed inside organizations' networks are ineffective for protecting these remote endpoints.

We believe that Qualys is one of the few companies well-positioned in this security market evolution due to our priority on investing in the extensibility and capabilities of our platform and our cloud-based architecture. Upon the onset of COVID-19, we addressed the needs of our existing customers by promptly releasing a remote endpoint protection service that would help them quickly address the challenge of securing these proliferating endpoints. This service, which we are providing at no cost for 60 days, leverages the Qualys Cloud Agent and its cloud-based architecture to deliver instant and continuous visibility of remote computers as well their installed applications, obtain a real-time view of all critical vulnerabilities and misconfigurations, and remotely deploy missing patches for critical vulnerabilities. These patches are delivered securely and directly from vendors' websites and content delivery networks, ensuring there is little to no impact on external VPN bandwidth. In Q2, we also added malware detection capabilities to the solution and customers that were already using the service could extend their free 60-day license for an additional 30 days. Malware detection uses file reputation and threat classification to detect known malicious files on endpoints, servers, and cloud workloads. In addition, this service is also now available to U.S. federal agencies via a no-cost 60-day pilot. We currently have over 650 companies, including nearly 300 customer prospects, actively using this free offering.

This Remote Endpoint Protection service is based on the multi-function Qualys Cloud Agent, which instantly provides visibility into remote endpoints, detects vulnerabilities, manages their security hygiene proactively, and patches them quickly at no cost. Our Cloud Agent is the technology platform for seven of our security, compliance and IT solutions – Vulnerability Management, Policy Compliance, File Integrity Monitoring, Indication of Compromise, Patch Management, Asset Inventory and the upcoming Certificate Management – with more to come.

In Q2, we continued to see strong growth in our paid Cloud Agent subscriptions, with almost 43 million now, representing 81% growth from the prior year quarter. We have continued to make strong progress on our goal of achieving ubiquity for our Cloud Agents. After organizations download our Cloud Agent once, it is frictionless for them to subscribe to our paid applications because no additional infrastructure is required to expand their solution with additional products. Furthermore, this multi-product adoption naturally increases the stickiness of our platform and helps make us impenetrable to our competition, who do not offer the same breadth of solutions or ease of adoption. This is demonstrated by the fact that the gross dollar retention rate of enterprise customers who have adopted 5 solutions or more stands at 99%.

Our Qualys Cloud Platform, combined with the capabilities of the powerful lightweight Cloud Agents, Virtual Scanners, and Network Analysis (passive scanning), allowed us to create an effective and seamless vulnerability management solution that incorporates the four key elements of discovery, assessment, prioritization, and patch management into a single application called VMDR (Vulnerability Management, Detection and Response), which went into general availability in April. This solution has been a huge success with customers and is also driving further penetration of our cloud agent. VMDR takes vulnerability management to the next level by providing the power to continuously detect vulnerabilities and misconfigurations across the entire

global hybrid IT environment and responding in real-time to remediate assets that are vulnerable or already compromised from a single platform with built-in orchestration. Currently over 600 customers have adopted VMDR, which includes approximately 200 new customers. In fact, 8 million out of our roughly 43 million paid Cloud Agents subscriptions have come from VMDR, of which 5.8 million were new agent subscriptions. VMDR has not only helped proliferate cloud agents, but also sets a foundation for further upsell of our other paid applications.

We continue to see good adoption of our free Global IT Asset Discovery and Inventory App with almost 14,000 companies signed up and over 1,350 companies actively using the service. In terms of our other newer solutions, we have continued to see strong customer adoption of our Patch Management solution both in the mid-market segment as well as at large customers. In Q2, a large IT services firm selected our patch management application over several competing solutions given its ability to easily and effectively patch remote endpoints without using limited bandwidth available on VPN gateways. This quarter, we also saw robust growth again for our Container Security application with a major enterprise video communications provider that has already deployed VMDR across its infrastructure, adopting the solution. In addition, our File Integrity Monitoring (FIM) application continues to see solid momentum with a large Asian airline having selected our FIM solution over a competing point solution in order to effortlessly leverage the Qualys Cloud Agents they had already deployed for Vulnerability Management.

Diving deeper, we were also early to recognize the importance of capturing all of the necessary telemetry via our sensors and the Internet while building the back-end with the scale and computing capabilities needed to handle such a large volume of data. Today, we handle more than 9 petabytes of data, indexing more than 7 trillion data points on our elastic search clusters, moving 14 billion messages a day on our Kafka bus, storing over 400 million objects in our Ceph clusters, and pumping 1 million writes per second in our Cassandra log analysis engine. As a result, our highly scalable cloud-based platform enables us to address all four new market segments - Large Enterprise, Cloud Providers, Next Generation Managed Security Service Providers and OT and IoT environments, providing a single-pane-of-glass view across on-premise assets, endpoints, cloud and mobile environments.

Last month, we introduced our Multi-Vector EDR solution that goes well beyond the endpoint and not only allows for the reduction of false positives, but also makes it easier to automate the response and greatly reduce the response time and costs. As an app built natively on the Qualys Cloud Platform, our Multi-Vector EDR leverages its power, scale and accuracy to provide unprecedented visibility and telemetry by collecting security data from endpoints, adding context and correlating billions of global events with threat intelligence, analytics and machine learning. To strengthen our entrance into the EDR market we acquired the software assets of Spell Security, a very innovative security startup in India and all Spell Security employees have joined Qualys in Pune. The team has unique expertise in threat hunting and malware research as well as a deep understanding of multi-vector attacks. They also have threat hunting products that will be fully integrated into the Qualys Cloud Platform.

Traditional EDR solutions singularly focus on hunting and investigating endpoints' malicious activities and cyberattacks. Qualys' multi-vector approach provides critical context and full visibility into the entire attack chain by providing a faster, more automated and comprehensive response to protect against attacks. We are delighted with the strong adoption of VMDR by both our customers

and managed security service providers and now by the interest Multi-Vector EDR is generating with them. Moving from VMDR to Multi-Vector EDR is almost instantaneous as it only requires an update of our cloud agent, which is automatically done by our platform once the application is enabled.

We are also pleased to announce that Infosys Managed Security Services has now adopted both VMDR and Multi-Vector EDR and here is a quote from Vishal Salvi, CISO and Head of Infosys Cyber Practice: “We are pleased to partner with Qualys to deliver VMDR and Multi-Vector EDR solutions via our globally distributed network of Infosys Cyber Defense Centers. The highly scalable Qualys Cloud Platform with its lightweight agent and sensors and its forthcoming incidence response capabilities provides us with all the intelligent analytics we need to effectively protect our clients and allows us to consolidate our security stack.”

At Black Hat, we also discussed our upcoming Data Lake / SIEM solution that we expect to have in early beta at the end of 2020. This is an important new milestone and new opportunity for our company as current incident response solutions have become quite complex and costly, requiring organizations to use multiple vendors to collect the data needed and bring it into their SIEMs with full contextual information. Qualys’ unique advantage is that we can leverage our robust scalable backend and its array of sensors which collect, enrich, normalize and correlate trillions of data points across on-premise, endpoint, cloud, mobile and soon OT and IoT environments.

On the hiring front, we are pleased to welcome back Joo Mi Kim as Chief Financial Officer of Qualys. Her extensive finance, strategic planning and investor expertise will be instrumental as we continue to expand the Qualys Cloud Platform and grow the company. We are also delighted that Ben Carr has joined Qualys as Chief Information Security Officer. Ben is a proven information security and risk executive and thought leader with more than 25 years of experience in executing long-term security strategies. At Qualys, he is responsible for providing cybersecurity guidance and security strategies to Qualys customers, leading the CIO/CISO Interchange and securing our IT infrastructure. Finally, we are also honored to welcome John Zangardi to our Board of Directors. John has extensive experience in digital transformation and has successfully transformed the infrastructure of both the DHS and the DOD as well as modernized their cybersecurity operations. We are grateful to gain his valuable insight and guidance as we continue to expand our cloud platform to deliver innovative security and compliance offerings.

In summary, because of the very nature of our business model, which is nearly 100% recurring and the fact that our solutions have become mission critical, we have a greater visibility than many other security companies in our industry, even in such difficult times, not to mention our highly profitable and cash generating business model. Our product and platform achievements lay the foundation for our continued progress to enable customers to consolidate their security, IT and compliance stacks while drastically reducing their spend. And importantly, it is core to the highly profitable recurring and growing revenue model we have built.

With that, I’ll turn the call over to Joo Mi to discuss our financial results and guidance for the third quarter and full-year fiscal 2020.

Joo Mi Kim, Chief Financial Officer

Thanks, Philippe and good afternoon. Before I start, I'd like to note that, except for revenue, all financial figures are non-GAAP and growth rates are based on comparisons to the prior year period, unless stated otherwise. We're delighted with our increasing Cloud Agent subscriptions and multi-product penetration as well as the strong adoption of VMDR, which lays the foundation for future revenue growth and industry-leading profitability. Our Q2 financial and operational highlights include:

- Revenues for the second quarter of 2020 grew 13% to \$88.8 million. Please note our Q2 2020 calculated current billings was negatively impacted by the timing and amount of prepaid multi-year subscriptions as well as requests for shorter duration invoicing, which we expect to continue to next quarter given the current market conditions;
- Our average deal size increased 7%;
- Platform adoption continued to increase as the percentage of enterprise customers with three or more Qualys solutions rose to 54% from 44% and the percentage of enterprise customers with four or more Qualys solutions increased to 38% from 24%;
- Paid Cloud Agent subscriptions increased to 43 million over the last twelve months, up from 38 million for the 12 months ended in Q1 2020; and
- 19% of VM customers up for renewal in the quarter renewed into a VMDR subscription, up from 4% in Q1.

Our scalable platform model continues to drive superior margins and generate significant cash flow:

- Adjusted EBITDA for the second quarter of 2020 was \$42.8 million, representing a 48% margin versus 42%;
- Q2 EPS grew 34%; and
- Our free cash flow for the second quarter of 2020 was \$24.9 million, representing a 28% margin and down 20% primarily due to recent changes in billing and payment terms for select customers given the current macroeconomic environment. YTD our free cash flow margin is 40% and is up 6%.

In Q2, we continued to invest the cash we generated from operations back into Qualys including:

- \$4.3 million on capital expenditures for operations, including principal payments under capital lease obligations; and
- \$25.3 million to repurchase 242,500 of our outstanding shares.

We remain confident in our business model, driven by our foundation of nearly 100% recurring revenues and expanding suite of applications. We are delighted to be raising our full year 2020 guidance for both revenues and earnings:

- We are raising the bottom and top end of our revenue guidance for the full year to now be in the range of \$359 to \$360.5 million from the prior range of \$354 to \$359 million;

- We are raising our full year non-GAAP EPS guidance to now be in the range of \$2.60 to \$2.65 from the prior range of \$2.46 to \$2.51. We expect to maintain industry-leading margins in 2020 and continue to produce strong cash flow; and
- Our Q3 guidance for revenue is \$91.6 to \$92.2 million and for non-GAAP EPS is \$0.65 to \$0.67. For the third quarter, we expect capital expenditures to be in the range of \$8 to \$9 million, which includes approximately \$2 million for the buildout of our Pune headquarters. Because of COVID-19 related delays, the timing of spend on our Pune headquarters has been pushed out a few months and we now expect that \$2 million of our original planned spend will occur in the second half of the year.

As Philippe mentioned, we are very excited by the robust early adoption of VMDR and the launch of our Multi-Vector EDR application. We feel very well-positioned during this period of uncertainty due to the value provided by our cloud platform and our 20 apps as well as our underlying highly scalable and profitable operational model. With that, Philippe and I are happy to answer any of your questions.

Closing Remarks

Thanks for attending our earnings call and for your questions.

These are obviously challenging times, but we feel fortunate to be very well-positioned with our cloud platform and apps. Our broad suite of IT, security and compliance applications, including our game-changing VMDR, Multi-Vector EDR and the forthcoming Data Lake / SIEM solutions help customers better manage their IT and security budgets by further consolidating their spend with us. I hope all of you remain safe and healthy.

Thanks again,
Philippe