Qualys Q2 FY2023 Earnings Prepared Remarks

Foster City, Calif., – August 3, 2023 – 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, 2023.

Blair King, Investor Relations

Good afternoon and welcome to Qualys' second quarter 2023 earnings call.

Joining me today to discuss our results are Sumedh Thakar, our president 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 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, and investor presentation are available on the Investor Relations section of our website. With that, I'd like to turn the call over to Sumedh.

Sumedh Thakar, president and CEO

Thanks, Blair, and welcome to our second quarter earnings call. We're pleased to announce that we delivered another quarter of healthy revenue growth and industry leading profitability, demonstrating our increasing leadership in cybersecurity risk management and firm foundation to drive future growth.

Q2 remained a tough period with customers continuing to scrutinize deals and delay project start dates. Nevertheless, the combination of today's uneven macro and heightened threat environment is driving the need for security stack consolidation necessary for clear security outcomes, reducing vendor sprawl in customer environments and implementing a long-term security strategy based on cost and value. Our risk management platform positions us well to deliver these outcomes to our customers and we feel fortunate that many of them are on a long-term transformation journey with us.

This was evidenced in Q2 by the steady adoption of our VMDR® (Vulnerability Management, Detection and Response) solution, which is now deployed by 52% of our customers worldwide. Key competitive VMDR wins with TruRisk included multiple customers both down market and in the Forbes 1000.

Qualys' VMDR solution continues to garnish significant industry recognition. As recently announced, Qualys' VMDR with TruRisk was voted the best risk management solution at the 2023 SC Awards Europe. This award evaluates vendors based on input from security practitioners and is held in high esteem. We believe Qualys' placement as the number one vulnerability management solution further validates our investments in the platform and represents the gold standard for securing customer environments today, and in the future.

Leveraging our VMDR and single agent approach, we've built a blueprint for delivering greater value to customers with multiple long-term drivers in our business. Let me highlight a couple of early platform successes we're seeing to broaden adoption with customers. In Q2, a Fortune 300 global manufacturing company chose Qualys because of our reputation to deploy across large, complex environments quickly. Their existing patch management solution was unable to effectively patch OS, iOS and third-party software, and they became victim to malicious activity. This customer needed to deploy a patch management solution quickly to over 40,000 assets to prevent a breach. The ability to deploy our solution the same day, using the same agents they had already deployed for VMDR, and without the need for a VPN, saved the company from manufacturing line productivity losses. Through this brief but urgent engagement, Qualys built additional trust with the customer by demonstrating our expertise, professionalism and technical efficacy. As a result, this customer is now evaluating our Cybersecurity Asset Management solution with external attack surface visibility to further streamline their security stack. With the Qualys Cloud Platform, they are eliminating legacy tools and have considerably improved their response time and security posture.

In another example of continued adoption of Cybersecurity Asset Management with external attack surface management, we also expanded our engagement with a Forbes 1000 food manufacturer in Q2. This customer expanded its deployment of VMDR with TruRisk and selected Qualys' Cybersecurity Asset Management and Patch Management as additional solutions. The ability to enhance its security program with comprehensive internal and external asset context, risk scoring, CMDB integration and fast remediation on a single console while consolidating agents on an integrated platform were all key differentiators in this win.

Further broadening our platform capabilities, you may recall in February of this year, we announced TotalCloud, a unified and extensible cloud-native CNAPP (Cloud Native Application Protection Platform) solution featuring agent and agentless zero-touch assessment scanning options along with CSPM (Cloud Security Posture Management), CWPP (Cloud Workload Protection Platform) and CDR (Cloud Detection and Response) capabilities to simplify workflows and help security teams migrate workloads to public and hybrid-cloud environments. With over 31 million cloud agents already supporting workloads in the cloud, we're quite encouraged by the customer feedback and early adoption we are seeing with our TotalCloud solution.

For example, in a recent mid six figure TotalCloud win, a leading cyber security company seeking better security against advanced threats in multi-cloud and container environments chose our solution over competing cloud security providers given its flexible scanning options, rapid detection and unparalleled remediation capabilities from development to runtime; all uniquely supported through our new adaptive subscription model, frictionless platform deployment and unified dashboard.

The wins I've shared here today, along with several others like them, underscore Qualys' ability to help customers not only detect, but also prioritize risk across all assets and environments while remediating vulnerabilities much faster than alternative siloed solutions. In today's current macroeconomic environment, we believe our value proposition becomes even stronger as customers seek multiple security offerings from a single Qualys platform.

With more and more customers beginning to perceive Qualys as a leading risk management platform that consolidates multiple security point solutions across all environments, we remain confident in our ability to drive long-term growth and gain market share. This confidence was again bolstered in Q2 as customers spending $500,000 or more with us grew 21% from a year ago to 168.

Continuing our disruptive innovation, I'm pleased to announce our groundbreaking launch of First-Party software Risk Management solution. With nearly every organization today becoming a software development house, most of them lack proper tools to detect, prioritize and remediate high risk vulnerabilities and misconfigurations within their own propriety codebase. This new capability now allows organizations to leverage their existing Qualys VMDR TruRisk platform deployment to not only detect CVEs in 3rd party software but also manage risks in their own first-party software using a single platform. Additionally, given high prevalence of embedded open source software like Log4J in these applications, this new capability allows customers to manage risk from these components and get a complete picture of their true risk. This new capability will be demonstrated at Blackhat next week.

Encouraged by the early adoption of TotalCloud, we've further harnessed technology from our recent acquisition of Blue Hexagon to extend our cloud-scale deep learning AI (Artificial Intelligence) based CDR (Cloud Detection and Response) capabilities into container images. By flexing the power of the Qualys Cloud Platform to discover and identify relationships and patterns within our own highly integrated data lake, we are now enabling organizations to rapidly predict, detect, prioritize and remediate anomalous activities that are invisible and undetectable in traditional signature-based solutions. This latest advancement empowers our customers to proactively hunt for and respond to zero-day threats spanning cloud and container environments from development to run time. This advanced AI based capability is already in action with some of our customers helping transform their security operations centers, magnifying our competitive differentiation in the market.

Looking ahead, we are further integrating our deep learning AI and ML technologies into our TruRisk Management and remediation solutions to include predictive insights of unknown vulnerabilities, misconfigurations and instances of active exploitation. And, with the algorithmic expertise already in-house, over the next few quarters, we expect to further extend these capabilities to transform the user experience on the Qualys Cloud Platform, harvesting trillions of data points, with rich investigation and remediation using generative AI.

In terms of our go-to-market initiatives, investing in our partner ecosystem continues to be a key priority. In Q2 we expanded our relationships with several key cloud partners, including AWS, which is now making our new product bundles aimed at SMBs/SMEs available in its marketplace. Additionally, we entered into a new partnership with a leading global MSSP, who chose Qualys over a competing detection only solution given our ease of orchestration, natively integrated platform and single agent approach to simplify its operations and significantly reduce remediation times for its customers.

Finally, I'm pleased to highlight that Dino DiMarino has joined Qualys as our new CRO. Dino has an established track record in driving new business development and leading channel partnerships at high growth SaaS, cloud and cybersecurity companies, most recently with Snyk. He will be responsible for all aspects of revenue performance with a focus on delivering sustainable customer value and business outcomes, the leadership of the worldwide sales and partner organization and accelerating Qualys' growth with both new and existing customers. Dino has over 20 years of executive sales experience and demonstrated success in bringing out the most in his teams, while successfully aligning sales with the product organization in support of the customer. He shares in our passion for product led growth, and we're looking forward to his contributions to Qualys.

In summary, our leadership as a trusted risk management platform of record and strong financial performance stand as a testament to Qualys' dedication to innovation, protecting customer environments and transforming the value proposition of traditional vulnerability management technologies with cyber risk posture assessment and response prioritization capabilities. With a unique opportunity in this environment to further strengthen our strategic position as the partner of choice for customers looking to rearchitect and consolidate their security tools to solve modern security challenges, we believe we can continue to grow long-term, maintain best-in-class profitability and invest in key initiatives aimed at further extending the gap between Qualys and the competition.

With that, I'll turn the call over to Joo Mi to discuss in more detail our second quarter results and outlook for the third quarter and full year 2023.

Joo Mi Kim, Chief Financial Officer

Thanks, Sumedh, and good afternoon. Before I start, I'd like to note that, except for revenues, all financial figures are non-GAAP and growth rates are based on comparisons to the prior year period, unless stated otherwise.

Turning to second quarter results, revenues grew 14% to $137.2 million. Revenues from channel partners grew 17%, continuing to outpace direct, which grew 12%. Channel revenue contribution remained the same as last quarter at 43%. By geo, growth in the US of 16% was ahead of our international business, which grew 12%. US and international revenue mix remained the same as last quarter at 60% and 40%, respectively.

Although customer dollar retention was largely unchanged in Q2, the selling environment was challenging with new business down and our net dollar expansion rate on a constant currency basis at 108%, down from 109% last quarter and 110% last year. While there continues to remain room for improvement from smaller customers spending less than $25,000 with us, we remain pleased with the continued strong revenue growth of 17% from larger spend customers.

In terms of new product contribution to bookings, Patch Management and CyberSecurity Asset Management combined made up 10% of LTM bookings and 19% of LTM new bookings in Q2. We attribute this success to our customers' need for broader contextualized awareness of their attack surface with natively integrated risk management and remediation workflows across all environments on a single platform.

Reflecting our scalable and sustainable business model, Adjusted EBITDA for the second quarter of 2023 was $65.8 million, representing a 48% margin, compared to a 45% margin a year ago. Operating expenses in Q2 increased by 6% to $53.4 million, primarily driven by investments in sales and marketing, including headcount. Although we remain focused on driving growth, with our disciplined approach to investing, we are being mindful of where to further increase investments while optimizing returns in others, which resulted in EBITDA margin exceeding our expectations in

Q2. This demonstrates our ability to maintain high operating leverage and remain capital efficient while continuing to innovate and invest to support our long-term growth initiatives.

With this strong performance, EPS for the second quarter of 2023 was $1.27, and our free cash flow for the second quarter of 2023 was $50.1 million, representing a 37% margin. In Q2, we continued to invest the cash we generated from operations back into Qualys, including $1.4 million on capital expenditures and $42.3 million to repurchase 346 thousand of our outstanding shares. As of the end of the quarter, we had $145.7 million remaining in our share repurchase program.

Before turning to guidance, I'd like to provide a few comments. We continue to foresee a challenging environment for new customer growth although we have been successful in building our pipeline and sales force. With the impact of the macro economy still unfolding, we are closely monitoring the business environment and shifting our priorities accordingly.

With that said, given our ratable, SaaS subscription model, our guide for revenue growth for the full year 2023 remains largely unchanged at 13% with the revised range of $553.0 million to $555.0 million, the high end of the range down from $557.0 million last quarter. For the third quarter of 2023, we expect revenues to be in the range of $140.5 million to $141.5 million, representing a growth rate of 12% to 13%.

Considering the long-term growth opportunities ahead of us and our industry leading margins implying further room for investment, we intend to continue to make responsible investments to align our product and marketing strategies. In doing so, we expect to prioritize these investments on specific initiatives aimed at driving pipeline growth and supporting sales. However, with our new CRO having just joined us this quarter, we naturally expect to revisit planned initiatives, which may push out some investments by a few quarters. As a result, we expect a full year 2023 EBITDA margin to be in the mid 40%s with full year EPS in the range of $4.50 to $4.65, up from the prior range of $4.13 to $4.28. For the third quarter of 2023, we expect EPS in the range of $1.10 to $1.15. Our planned capital expenditures in 2023 are expected to be in the range of $10 to $15 million and for the third quarter of 2023, in the range of $2 to $4 million.

In conclusion, in Q2 we delivered a healthy top line growth and industry-leading profitability and we remain confident in our ability to deliver on our growth opportunity long-term, while investing responsibly to maximize shareholder value.

With that, Sumedh and I would be happy to answer any of your questions.