



Qualys Q4 FY2018 Earnings Prepared Remarks

Foster City, Calif., – Feb. 12, 2019 – Qualys, Inc. (NASDAQ: QLYS), a pioneer and leading provider of cloud-based security and compliance solutions, today announced financial results for the fourth quarter ended December 31, 2018.

Natasha Asar, Investor Relations

Good afternoon and welcome to Qualys' fourth quarter and full year 2018 earnings call.

Joining me today to discuss our results are Philippe Courtot, our chairman and CEO, and Melissa Fisher, 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, and an accompanying investor presentation with supplemental information 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 Q4 earnings call.

Melissa and I are pleased to report another strong quarter and year in terms of revenue growth and profitability. These results underscore our position as the leading cloud-based security and compliance platform that unifies IT, security and compliance in a single-pane-of-glass view with two-second visibility across on-premises assets and clouds. With 19 Cloud Apps native in our platform, we believe we are well positioned to expand our wallet share within our growing user base as well as gain new customers.

At our user conference in November, we observed that our customers increasingly view Qualys as a trusted strategic partner. The digital transformation of businesses, fueled by an explosion of new technologies, is leaving gaping security holes in its wake. Organizations who are continuing to layer on point solutions that do not communicate with each other are seeing diminishing returns. Qualys delivers a true platform, offering greater visibility, accuracy, and scalability across hybrid and cloud environments while ultimately allowing customers to reduce their overall spend.

To achieve security and compliance in this new hyper-connected environment and respond to an ever-increasing set of regulations, we believe that organizations, in addition to deploying traditional firewalls and intrusion detection, must:

- Know in real-time what devices and applications are connected on the network;
- Always know the security and compliance posture for every device both known and unknown; and
- Take immediate remediation action whenever necessary.

This is precisely where traditional enterprise solutions are falling short as they were not designed to operate at such a scale and in reality, only solutions that adopt a cloud-based architecture can provide the necessary scale, visibility, correlation and immediacy.

We demonstrated to our customers at our user conference the significant extensions we have made to our cloud-based platform and Cloud Apps. In 2018:

- We launched several new solutions into general availability or beta, including Container Security, Cloud Inventory, Cloud Security Assessment, Certificate Inventory, Certificate Assessment as well as our new groundbreaking app for global IT Asset Inventory (AI) and CMDB Synchronization. Our AI cloud app, formally launched yesterday, enables us to offer our customers a single 'source of truth' for all IT assets within hybrid environments, covering on-premises assets, endpoints, clouds, and soon, mobile, OT and IOT environments;
- We also demonstrated our Passive Network Analysis solution (now in beta) that natively integrates network analysis functions (deep packet inspection, device fingerprinting and data correlation) into the Qualys Cloud Platform, delivering customers complete IT visibility at scale. This new capability will enhance our global IT Asset Management offering by adding the visibility of unknown assets to the existing capabilities;
- We acquired 1Mobility, completed in Q2, which will enable us to provide enterprises discovery, inventory, security, compliance and response on both enterprise-owned as well as employee-owned mobile devices, further expanding our footprint within our customer base; and
- We completed the acquisition of Layered Insight, a pioneer and global leader in runtime container security, which will provide insight into container images, adaptive analysis of running containers, and automated enforcement of policy. We are currently integrating Layered Insight's technology into the Qualys Container Security App, which will allow us to uniquely bring transparent orchestration to container security. We expect to complete this integration in the second half of this year.

In the fourth quarter, we continued to expand our partnerships:

- integrating with the AWS Security Hub, introducing Qualys vulnerability and policy compliance findings within AWS Security Hub;
- launching the Qualys Container Security solution on the new AWS Marketplace for Containers; and
- we announced today an expanded relationship with IBM X-Force Red who will deploy Qualys Patch Management (PM) and Web Application Scanning (WAS) into global client environments along with its existing Vulnerability Management (VM) deployment. This expansion enables X-Force Red Vulnerability Management Services (VMS) to automate vulnerability prioritization and patching, enabling clients to simplify vulnerability remediation and fix their most critical vulnerabilities using less resources and time.

These activities build upon our go-to-market accomplishments earlier in 2018:

- Expanding our capabilities in the Federal market with a deeper partnership with Carahsoft to market, sell and distribute the FedRAMP-authorized Qualys Gov Platform, and are now working on attaining FedRamp High certification;
- Broadening our relationships with key partners, including Microsoft and IBM by adding an integration into Microsoft's hybrid cloud, Azure Stack, releasing monitoring and assessment for the CIS (Center for Internet Security, Inc.) Microsoft Azure Foundations Benchmark within our Cloud Security Assessment (CSA) Cloud App, adding an integration with X-Force Red, which will deploy the Qualys Cloud Agent and Qualys Cloud Apps into client environments across the globe, and adding an integration with IBM's first open cloud platform (IBM Security Connect);
- Releasing our Qualys Community Edition, a free version of our cloud platform to provide organizations including SMBs, consultants and managed service providers (MSPs) with a unified view of IT, security and compliance, as well as two other free services, CloudView and CertView, providing companies of all sizes the instant ability to track and monitor digital certificates and cloud resources; and
- Launching a new comprehensive offering, the Qualys Consulting Edition, for consultants, consulting organizations and MSPs, enabling them to perform multiple ongoing vulnerability assessment engagements and track these results from a single, centralized and self-updating platform.

Building upon a very successful 2018, we will continue to increase our competitive advantage by releasing new groundbreaking security and compliance applications, leveraging both our talent base as well as acquired technologies. Our current plans in 2019 include:

- the release of new solutions such as Passive Network Discovery, Secure Access Control, Certificate Management and Cloud Security Management;
- the general availability of Patch Management, announced today, enabling IT and SecOps teams to quickly target critical common vulnerabilities and exposures, then deploy the patches across endpoints, on-premises or cloud assets and verify remediation - all from one console;

- continued acquisitions to enhance our product suite. In January, we completed the acquisition of Adya, a small innovative Indian startup that built their solution on the AWS Lambda platform. Adya's solution enables security and compliance audits of SaaS applications, which is becoming critical to enterprises as they increasingly rely on cloud-based software. The Adya cloud-based solution provides companies of all sizes with the ability to consolidate administration of their Software as a Service (SaaS) applications into one console, manage license costs across SaaS applications, set and enforce security policies in one place and report and audit on all activity with a single tool; and
- to invest significantly in our backend, continuing to enhance what we believe to be the most robust and scalable cloud platform in our market. We now have almost two trillion security data points indexed in our elastic search clusters, providing almost instant query results and alerts. This gives our customers 2-second visibility, and as we know, visibility is the keystone of security.

To support the significant number of additional solutions we are bringing to market, we increased our sales organization in the second half of 2018 by over 20% and we will continue to do so over the next year. We expect to continue to outperform market growth in 2019 while producing high levels of profitability. We are very optimistic about the opportunity to increase bookings growth in the future because our newest solutions, which solve meaningful problems for customers, are priced similar to or at a premium to Vulnerability Management and Policy Compliance (as compared to Cloud Agent and Threat Protection which are priced at a fraction of Vulnerability Management and Policy Compliance). Qualys continues to clearly move well beyond vulnerability management and increase its competitive advantage through the acceleration of multi-product adoption. This naturally increases our stickiness, which is a key element of our profitable growth, driving value for our shareholders.

With that, I'll turn the call over to Melissa to discuss our financial results, guidance and metrics.

Melissa Fisher, 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. Our solid Q4 financial and operational results continue to reflect the healthy demand for our scalable and robust Cloud Platform. This is evidenced in the following financial and operational highlights:

- Revenues for the fourth quarter of 2018 grew 18% to \$74.2 million;
- Platform adoption continued to increase as the percentage of enterprise customers with three or more Qualys solutions rose to 41% from 32% and the percentage of enterprise customers with four or more Qualys solutions increased to 21% from 15%;
- New products released since 2015 contributed approximately 26% of total bookings in the quarter, up from 15%; and
- Similar to Q3, we saw higher growth in the total number of orders from our SME and PCI customers. This positive result pulled our historical year-over-year average deal size increase down to 5%; however, the average deal size for our enterprise

customers grew 11% year-over-year.

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

- Adjusted EBITDA for the fourth quarter of 2018 was \$29.1 million, representing a 39% margin versus 38%; for comparability purposes, Q4 Adjusted EBITDA margin would have been 37%, normalized for the impact of 606 and software capitalization;
- Q4 EPS grew 62% including the benefit of a tax true-up; normalized for this, Q4 EPS would have grown a healthy 44%; and
- We generated strong operating cash flow for the fourth quarter of 2018 of \$26.7 million, an increase of 3%.

In Q4, we continued to invest the cash we generate from operations back into Qualys including:

- \$3.7 million on capital expenditures, including principal payments under capital lease obligations;
- \$10.3 million on the acquisition of Layered Insight; and
- \$38.5 million to repurchase 521,257 of our shares.

Looking back on the year, we had a successful 2018 at Qualys as we:

- released several new products, features and enhancements, completed two acquisitions and made our first minority investment;
- saw an acceleration in the number of customers spending \$500,000 or more;
- enjoyed continued Cloud Agent adoption with 16.2 million Cloud Agents purchased over the last twelve months, up from 6.0 million, over 150% growth;
- benefited from strong performance from new products released since 2015 which, at 20% of 2018 bookings – almost double the prior year – contributed to growth of our subscription revenues by 20%, normalized for the positive impact of fx; and
- achieved record EBITDA margins of 39% and grew operating cash flow 17%, normalized for the 606 benefit, software capitalization and our investment in 42Crunch - despite our continued investment in the business, including 37% year-over-year growth in headcount in 2018.

Looking to 2019, we expect full year revenue in the range of \$320 million to \$323 million, which represents a growth rate of 15% to 16% and Q1 revenue in the range of \$74.5 million to \$75.2 million, which represents a growth rate of 15% to 16%. We are excited about the opportunities to accelerate revenue growth with our new solutions. Many of our newest solutions, for example, FIM, IOC and AI, are priced similar to or at a premium to Vulnerability Management and Policy Compliance. As you have seen, multi-product adoption has increased quarter after quarter however these newer solutions are still early in their adoption and consistent with prior years, we are not assuming a material contribution from new solutions in our guidance. Furthermore, the large deal we referenced on our Q3 earnings call has not yet concluded.

In terms of 2019 profitability, we expect to maintain industry-leading margins while further investing to set the stage for future revenue growth. While we achieved record profitability in 2018, we invested in the business throughout the year, particularly in building our team, driving our record 2018 headcount growth of 325 employees. This spend was back-end loaded, and combined with additional expenditures we plan to make in 2019 across our engineering, sales and marketing, operations and administrative functions, will result in our EBITDA margin in FY 2019 in a range of 37% to 38% based on our current forecasts. We expect capital expenditures from operations to be roughly flat with 2018, in a range of \$22 million to \$27 million. We will continue to invest to support the growth of the business but we will benefit from earlier investments in building out data center and U.S. office locations. Additionally, we expect to purchase less hardware for physical scanner subscriptions as customers increasingly subscribe to virtual scanners. As we have significantly increased our employee base in Pune, we expect to spend an additional \$4 million in the second half of 2019 for the beginning of our buildout of a new Qualys facility in Pune. For the first quarter of 2019, we expect capital expenditures to be in the range of \$8.5 to \$9.5 million. Even with all of these infrastructure investments, we expect our year-over-year free cash flow growth to exceed the earnings growth currently implied by our guidance.

We feel very well-positioned in our markets given the unique nature of our integrated IT, security and compliance Cloud Platform. Our customer count growth accelerated in 2018 and we added almost 1,100 active users to our free solutions. Our new solutions provide the opportunity for us to increase average revenue per user, accelerate revenue growth and, driven by our highly scalable model, expand margins in the future. Our focus continues to be growing our foundation of recurring revenues and maintaining strong profitability.

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