



## Qualys Q1 FY2020 Earnings Prepared Remarks

**Foster City, Calif., – May 7, 2020** – [Qualys, Inc.](#) (NASDAQ: QLYS), a pioneer and leading provider of cloud-based IT, security and compliance solutions, today announced financial results for the first quarter ended March 31, 2020.

### **Vinayak Rao, Investor Relations**

Good afternoon and welcome to Qualys' first quarter 2020 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, 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 Q1 earnings call. We hope that you and your families are healthy and safe and that soon America and the world will be open for business again.

It is now clear that, after COVID-19, organizations and government agencies of all size are going to have to:

- Rethink their security and business continuity plans to include remote connectivity;
- Accelerate their migration plans to the cloud; and
- Streamline and secure if not re-invent their supply and delivery chains.

This will have a profound impact on our industry as it has also become clear that most of the current security solutions were not designed for a remote and highly interconnected working new world.

In fact, we experienced this ourselves, as like most other companies, we suddenly had most of our workforce working from home. Fortunately, because we had moved early with cloud-based enterprise applications and spent many years laying the architectural foundational work for a robust scalable cloud platform, we were able to not only secure our remote workers' computers but also continuously monitor and patch vulnerabilities in a very short period of time. As a result, we could continue our engineering and business development initiatives without much disruption.

This was the genesis for launching a cloud-based Remote Endpoint Protection solution, in a matter of days, as a free service for our customers first and now for the community at large by leveraging our powerful cloud platform and our strong base of engineering talent in Pune. As a result, today, we have close to 500 companies, of which nearly 50% are new customer prospects, signed up for this free offering which allows security teams to gain instant and continuous visibility of remote computers, easily see missing patches for critical vulnerabilities and deploy them from the cloud. This represents a deployment of 2.1 million cloud agents on the endpoints (1.4 million from existing customers and 700K from new prospects). The patches are delivered securely and directly from vendors' websites and content delivery networks ensuring there is little to no impact on external VPN bandwidth.

We are now planning to add malware detection capabilities in a couple of weeks and will extend the FREE service for another 60 days for those who adopt the malware detection capabilities, which will be a prelude to bringing the power of our Cloud Platform, agent and passive technology to EDR, a new offering we plan to release this summer and to the Security and Event Management market later in the year.

What makes Qualys unique is the significant investment we have made and our determination over the years to build a highly scalable cloud-based platform that allows us to unify IT, security and compliance across the new hybrid environment. Early on, we recognized the importance of capturing all the necessary telemetry via our sensors, via the Internet and 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 6 trillion data points on our elastic search clusters, moving 5 billion messages a day on our Kafka bus and pumping 1 million writes per second in our Cassandra log analysis engine.

As a result, our cloud-based IT, security and compliance solutions do not need to collect data from disparate sources, are easily deployable in environments with a dispersed and remote workforce and this is what drove, in such difficult times, another good quarter in terms of revenue growth and profitability. This is underscored by the continued acceleration in our paid Cloud Agent subscriptions, with over 38 million now or 114% growth from the prior year quarter.

We continue to see good adoption of our free Global IT Asset Discovery and Inventory App with almost 9,000 new companies signed up and over 700 new companies actively using the service.

We now also have over 600 existing customers using this solution. We saw solid growth this quarter from our paid IT Asset Discovery and Inventory and Cloud and Container solutions; in fact, a leading financial services company added our IT Asset Discovery and Inventory paying module this quarter in order to gain visibility of all their known and unknown assets across multiple environments, identify the end of life of their installed software and synchronize with their ServiceNow CMDB. Also, a large existing bank customer which had acquired a competitor used this opportunity to not only adopt VMDR but also to add many of our newer solutions like FIM, Container Security and Cloud Security Assessment as they could consolidate many of their existing security solutions in a single stack where all the data could be correlated far more cost effectively to provide a continuous and accurate view of their security and compliance posture across their entire environment. Finally, Patch Management continued to see strong customer adoption in the mid-market segment this quarter and we are seeing strong interest with our large customers as well.

We are also pleased to announce that Qualys Container Security application is now available, and Qualys Vulnerability Management will be available within a month in Microsoft Azure Security Center to all their customers that are on Azure Security Center Standard Edition. This jointly developed solution automatically analyzes virtual machines and container images in Azure, providing customers visibility into vulnerabilities and configuration issues, which are reported to Microsoft Azure Security Center as recommendations, including the ability to create playbooks for one-click remediation with no software to deploy or update.

Our Security Conference during RSA in Q1, where we unveiled Vulnerability Management, Detection and Response (VMDR) now in GA, was a huge success. VMDR takes vulnerability management to the next level by providing the power to continuously detect vulnerability and misconfigurations across the entire global hybrid IT environment and respond in real-time to remediate assets that are vulnerable or already compromised from a single platform with built-in orchestration. We held a live virtual event on April 21 demonstrating how VMDR integrates Asset Discovery and Inventory with Vulnerability Assessment and Patch Detection in a single app.

More than 3,000 people had registered for our VMDR live event and over 600 organizations signed up for a VMDR trial after this event, 75% which were new customer prospects. The Head of Security Research at Orange Cyber Defense, one of our MSSP partners, concluded that VMDR is going to shake up the vulnerability management space given its focus on inventory, risk-based priorities and workflows as well as its strong use of elastic search capabilities. In fact, Armor saw the opportunity to integrate VMDR with the Armor Anywhere managed security offering and Armor Anywhere customers will now have access to the newly announced Qualys VMDR application as part of a holistic solution to meet their Vulnerability Threat Management (VTM) requirements and provide visibility across their entire hybrid IT environment. Qualys Cloud Agents are embedded and fully integrated with the Armor platform to deliver asset discovery and inventory, vulnerability assessment including configuration controls, threat prioritization and patch detection to Armor customers.

In addition, this quarter Qualys was recognized as a Gartner Peer Insights Customers Choice for Vulnerability Assessment. VMDR is effortless to deploy on a global scale, and priced as a fully bundled solution, drastically saving deployment, administration and software subscription costs

with real-time, light-weight Cloud Agents and Virtual Scanners that are self-updating and easy to deploy.

Our game-changing VMDR application was also highlighted during the quarter in a report by Ovum, a market-leading data, research and consulting firm and you can review it at [www.qualys.com/forms/whitepapers/ovum/](http://www.qualys.com/forms/whitepapers/ovum/). In Q1, nearly 150 customers adopted VMDR, which included approximately 60 new customers and 7 of our top 10 existing customers up for renewal in Q1 renewed into VMDR subscriptions. In fact, 3.9 million out of our over 38 million paid Cloud Agents subscriptions came from VMDR, of which 3 million were new agent subscriptions, laying the foundation for ubiquity of our agents which is the technology platform for seven IT, security and compliance 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 addition, earlier this month we also announced general availability of the Qualys Cloud Agent on the Google Cloud Platform (GCP). GCP customers can now easily activate multiple Qualys applications, including our game changing VMDR application, to build a streamlined workflow within GCP.

Also, at our user conference this past quarter, we participated in a number of impromptu videos, which you can access at [www.qualys.com/qsc/2020/san-francisco/](http://www.qualys.com/qsc/2020/san-francisco/). These videos underscore the fact that the security industry is on the verge of a major transformation as many of the current solutions offered by a plethora of vendors are becoming inadequate as the architecture of our corporate networks is drastically and rapidly changing. We saw this coming quite a while ago and as mentioned earlier, we took the time to properly build our offerings with this need in mind. These efforts built the foundation for our leadership position in our markets and we continue to innovate, first with VMDR, which went live in April, and with the next generation SIEM and EDR, which we expect to deliver for beta at the end of the year as well as significant extensions, similar to VMDR, to our current offerings providing detection and response capabilities across cloud(s), mobile, SaaS and OT and IoT environments by adding response capabilities to our cloud agents and additional detection capabilities to our network analysis efforts.

Looking forward, we believe the world after COVID-19 is going to be different. Companies are going to be more focused on reducing costs while increasing business flexibility, which is going to be a significant driver to a faster adoption of cloud-based solutions. In the current uncertain environment, we are fortunate to have a stable foundation of recurring revenues and a highly profitable model, which we believe can withstand short-term disruptions.

Finally, 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 stellar profitability.

With that, I'll turn the call over to Melissa to discuss our financial results and guidance for the second quarter and full-year fiscal 2020.

## **Melissa Fisher, Chief Financial Officer**

Thanks, Philippe and good afternoon. I would like to reiterate Philippe's comments that we hope our investors and analysts are all safe and healthy. 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 Q1 financial and operational highlights include:

- Revenues for the first quarter of 2020 grew 14.5% to \$86.3 million. Please note our Q1 2020 calculated current billings was positively impacted by the timing and amount of prepaid multi-year subscriptions somewhat offset by a few large deals that were invoiced in Q4 2019, rather than at their anniversary in Q1 2020;
- Our average deal size increased 3%;
- Platform adoption continued to increase as the percentage of enterprise customers with three or more Qualys solutions rose to 50% from 42% and the percentage of enterprise customers with four or more Qualys solutions increased to 32% from 22%;
- Paid Cloud Agent subscriptions accelerated to 38.4 million over the last twelve months, up from 30.7 million for the 12 months ended in Q4 2019. 3 million Cloud Agents were purchased this quarter by a single customer; and
- New products released since 2015 contributed approximately 44% of total annual bookings in the quarter, up from 23%. Since this metric includes VMDR, we expect it to become less relevant for investors as more VM customers renew into VMDR over the coming quarters. As a result, we do not plan on providing this metric going forward, but we plan to introduce new metrics relevant to VMDR adoption such as the percent of customers up for renewal in the quarter who renewed into a VMDR subscription; in Q1, this was 4%. Because VMDR is an integration of multiple Apps, VMDR adoption should increase our strong renewal rates.

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

- Adjusted EBITDA for the first quarter of 2020 was \$38.2 million, representing a 44% margin versus 41%;
- Q1 EPS grew 34%; and
- Our free cash flow for the first quarter of 2020 was \$45.1 million, up 28%. Excluding one-time capex related to the buildout of our Pune HQ and M&A-related payments, our free cash flow grew 36%.

In Q1, we continued to invest the cash we generated from operations back into Qualys including:

- \$4.7 million on capital expenditures for operations, including principal payments under capital lease obligations, as well as \$2.6 million on capital expenditures for the buildout of our Pune headquarters; and

- \$28.9 million to repurchase 346,250 of our outstanding shares. Our Board has authorized an additional 2-year \$100 million open market share repurchase program, resulting in approximately \$200 million in current share repurchase capacity. This gives us ample capacity to take advantage of any potential stock market dislocations.

Now I want to share our thoughts on the potential impact on our business from COVID-19 this year. As Philippe mentioned, we consider ourselves fortunate relative to other companies because we have a strong sustainable and profitable business model. The fundamentals of our company remain strong:

- We have a healthy balance sheet with \$435 million of cash and marketable securities as of the end of the quarter and we have no debt;
- Our exposure to the retail, travel and hospitality sectors is minimal. Less than 5% of our trailing 12 months annual bookings came from customers in these segments;
- To date, we are seeing consistent renewal rates across our business in all geographies and solid expansion with existing customers;
- 18% of enterprise customers had five or more Qualys solutions and as we've discussed, our 5+ enterprise customers had a gross dollar renewal rate of 99% in 2019; and
- We increased the number of customers with over \$500,000 of revenues over the last 12 months by approximately 30% to 96 at the end of Q1.

Additionally, because our business is nearly 100% subscription, we have good visibility into our financial performance:

- Our updated FY20 guidance range for revenue is \$354 million to \$359 million. Our updated FY20 revenue guidance assumes that, similar to other companies, our revenues may be impacted in the next few quarters by organizations that defer purchases of new solutions as they focus on business operations and small and medium-sized companies that may need to reduce spend;
- Our updated FY20 guidance range for non-GAAP EPS is \$2.46 to \$2.51. Because of our highly profitable model, we intend to continue investing at a similar level to what we planned for at the beginning of the year in order to maintain our strong competitive position and drive future revenue growth. We expect to maintain industry-leading margins in 2020 and continue to produce strong cash flow. Impacting our non-GAAP EPS guidance by \$0.06 vs. what we provided last quarter is the recent decline in interest rates which we estimate will result in approximately \$1 million lower interest income per quarter; and
- Our Q2 guidance for revenue is \$88.0 to \$88.6 million and our Q2 guidance for non-GAAP EPS is \$0.63 to \$0.65. For the second quarter, we expect capital expenditures to be in the range of \$5 million to \$6 million, which includes approximately \$1.5 million for the buildout of our Pune headquarters. Because India has also been operating under a shelter in place, the timing of spend on our Pune headquarters has been pushed out a few months and we now expect that \$1 million of our original planned spend will occur in the second half of the year.

To follow on Philippe's comments, we feel very well-positioned during this period of uncertainty

due to the value provided by our cloud platform and our 19 apps as well as our underlying highly scalable operational model. We believe we will emerge stronger from this as our model enables us to continue both helping our global community and investing for future revenue growth and profitability. 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, including our game-changing VMDR application. We are continuing to grow our pool of topnotch talent, so we emerge stronger than ever to serve our global community, employees and shareholders. I hope all of you remain safe and healthy.

Thanks again,  
Philippe