Qualys Q3 FY2018 Earnings Prepared Remarks

Foster City, Calif., – Oct. 30, 2018 – Qualys, Inc. (NASDAQ: QLYS), a pioneer and leading provider of cloud-based security and compliance solutions, today announced financial results for the third quarter ended September 30, 2018.

Natasha Asar, Investor Relations

Good afternoon and welcome to Qualys' third quarter 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 Q3 earnings call.

Melissa and I are pleased to report both continued revenue growth and profitability. These results reflect our position as a leading cloud-based security and compliance platform unifying IT, security and compliance in a single-pane-of-glass view with two-second visibility across on-premises assets, endpoints, clouds, and soon, mobile, OT and IOT environments. Such capability is the keystone of security, as there is no security without visibility. To that effect, I invite all of you to watch a short video at www.qualys.com/visibility so you could experience it for yourself.

This unique competitive position was in fact reinforced when I met many of our European

customers earlier in the month in Monaco at Les Assises de La Securite, the leading security conference in France. They shared with me their view that they see Qualys as a strategic partner as they move to consolidate their current security and compliance stacks and accelerate their digital transformation in part because of GDPR as well as by the need to remain competitive.

As we continue delivering additional best-of-breed compliance and security applications natively integrated within our Cloud Platform and expanding our offering on public cloud platforms (Amazon AWS, Microsoft Azure, Google Cloud and soon, IBM Security Connect), we believe that we naturally increase our stickiness and drastically reduce both cost and complexity for our customers.

This is underscored by the fact that we continue to innovate and deliver on our product roadmap and in Q3:

- We showcased the Passive Network Sensor (PNS), a new member of the Qualys sensor family that natively integrates network analysis functions (deep packet inspection and data correlation) into the Qualys Cloud Platform, delivering customers complete IT visibility at scale. In combination with our existing data gathering sensors, specifically scanners and Cloud Agents, and our groundbreaking app for global IT Asset Inventory and CMDB Synchronization (ITAM), this new capability enables us to offer our customers a single 'source of truth' for all IT assets within hybrid environments, including on-premises assets, endpoints, clouds, and soon, mobile, OT and IOT environments.

- We now have more than 30 customers using our ITAM App for known assets in beta and expect to go GA in November; our Passive Network analysis for unknown assets will go into beta in November and is expected to go GA by year end.

- We also announced a new Out-of-Band Configuration Assessment (OCA) Cloud App that allows customers to achieve complete visibility of all known IT infrastructure by pushing vulnerability and configuration data to the Qualys Cloud Platform from systems that are otherwise difficult or impossible to assess such as highly locked-down devices and on air-gapped networks.

Our expanded relationships with Microsoft and IBM are a testament to the tremendous value our cloud platform offers to customers. This quarter:

- We added an integration into Microsoft's hybrid cloud, Azure Stack, which allows us to provide a single-pane view of the security and compliance posture of Microsoft Azure infrastructure and user workloads – across Microsoft Azure as well as Azure Stack;

- We announced our release of monitoring and assessment for the CIS (Center for Internet Security, Inc.) Microsoft Azure Foundations Benchmark within our Cloud Security Assessment (CSA) Cloud App to enable our customers to build security into DevOps initiatives;

- We also announced an expanded partnership with IBM whereby X-Force Red will deploy the Qualys Cloud Agent and Qualys Cloud Apps into client environments across the globe,

providing a programmatic vulnerability management approach that leverages the breadth of Qualys' continuous visibility and depth of the X-Force Red team's services to identify, prioritize and remediate clients' most critical vulnerabilities; and

- We were selected as a key partner for IBM's first open cloud platform (IBM Security Connect) to federate and analyze security data at scale. With IBM's open cloud platform, enterprises will be able to view their Qualys data across applications, integrated with their network and other security solutions.

Adding to our product capabilities, in October we completed the acquisition of Layered Insight. Layered Insight, based in the Bay area, is the pioneer and global leader in container native application protection, providing accurate insight into container images, adaptive analysis of running containers, and automated enforcement of the container environment. By integrating Layered Insight's unique technology into the Qualys Container Security App, we will add the ability to provide dynamic analysis of running containers, and automated enforcement of the container environment.

Layered Insight's unique technology brings transparent orchestration to container security. The ability to instrument images pushes automated deployment deep into the DevOps CI/CD pipeline, thus removing the resistance at deployment. This instrumentation provides real-time visibility into containers at run-time complementing our current capabilities of accessing container images in the build system for vulnerabilities and configuration issues. With this layered-in approach, there is no sidecar or privileged container needed by the solution, making it an ideal solution for Intelligent Edge and serverless Container-as-a-Service (CaaS) deployments like AWS Fargate, which are quickly becoming the future of containers like IaaS and PaaS. Through the layered-in presence in the applications, the solution also provides protection, policy-based remediation and response capabilities that further simplify end-to-end container security. We expect quick integration into our Cloud platform with general availability in Q2 2019.

In line with our acquisitions made to date, key employees have joined Qualys including Asif Awan, as CTO of container security and John Kinsella as VP Engineering, container security.

In summary, our acquisitions complement our organic innovation, expanding our Cloud Platform to provide more comprehensive security and compliance coverage on the application side, customer-owned web apps and provider-hosted SaaS web applications, and also providing visibility across all global IT assets including web applications, containers, APIs, OT and IOT devices.

We continue to make good progress in penetrating the federal market:

- We were delighted to win a large multi-product deployment with DHS, which was a competitive displacement; DHS has licensed Qualys' platform in support of the National Cybersecurity Assessment and Technical Services (NCATS) mission. Qualys will be used in the DHS initiatives for protecting critical infrastructure and elections security.
- Additionally, Cindy Stanton joined as VP, Product Marketing for both Public Sector and Cloud Providers. Cindy previously worked at Alert Logic and Verizon Business and will

leverage her experience to develop programs supporting Federal agencies on their digital transformation and cloud security initiatives.

Additionally, we continue to leverage the Qualys Cloud platform as a distribution channel:

- We announced a new comprehensive offering for consultants, consulting organizations and managed service providers (MSPs), the Qualys Consulting Edition, enabling them to perform multiple ongoing vulnerability assessment engagements and track these results from a single, centralized and self-updating platform; and

- We have seen a great response to the releases of CloudView, CertView and the Qualys Community Edition, a successful lead-generation effort which serves to distribute our Qualys Cloud Platform to more users from which we can sell many additional solutions. We have over 12,000 activations now, out of which almost 6,000 are active users already, which is significant growth from the over 6,500 activations and 700 users we had at the end of Q2 2018.

We are excited to host our customers and partners at our upcoming QSC user conference in Las Vegas on November 14th and 15th. We expect this user conference to be significant for our company as we believe that it will be evident that we have moved well beyond vulnerability management and, in fact, are bringing IT, Security and Compliance together across environments, drastically reducing the cost of deploying and maintaining traditional enterprise solutions, due to our cloud architecture:

- At the conference, our Chief Product Officer Sumedh Thakar will showcase our new groundbreaking Global IT Asset Inventory solution, which is always up to date with two-way synchronization with CMDBs, and enables organizations to regain full visibility across their on-premises, cloud(s), mobile, OT and IOT environments.

- We will also showcase our new customizable dashboards that provide real-time analysis of your security and compliance posture in a single-pane view and that identify in seconds assets that are vulnerable to zero-day attacks or that have been compromised or are suspicious.

- Finally, among other innovative solutions, we'll unveil and discuss:
   - Our forthcoming patch management and mitigation solutions;
   - A novel approach to container security; and
   - How Qualys can help build security into your DevOps and digital transformation initiatives

- At the conference, our attendees will also have the opportunity to discuss and listen to customers who will share their experiences and best practices. Click here to see agenda.

Our institutional investors and analysts are invited to attend QSC as well. We are hosting a dedicated track for this community on November 15th, which will include a demonstration of our newest applications in the platform by our Chief Product Officer Sumedh Thakar, a financial

update by our Chief Financial Officer Melissa Fisher, customer speakers and industry analysts. Register here.

Before I turn the call over to Melissa to discuss our financial results, I would like to welcome Patricia Hatter to our Board; Patty brings unique experience as both a buyer and seller of security and IT solutions, given her prior roles as both the CIO and SVP of Operations at McAfee, as well as the SVP of Services. In addition, she also served as GM of Security & Software IT and CIO for Intel Security, and also held a variety of leadership roles at Cisco and AT&T. As we continue to expand the breadth of applications unifying IT, security and compliance, we expect to leverage her expertise as we increasingly sell our integrated Cloud platform to CIOs and CISOs.

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, unless stated otherwise. As Philippe mentioned, our continued healthy financial results reflect our strong competitive position and continued platform adoption.

I'd like to share the following Q3 financial and operational highlights:

- Revenues for the third quarter of 2018 were $71.7 million, which represents 20.5% growth over the same quarter last year;

- Platform adoption continues to increase as the percentage of enterprise customers with three or more Qualys solutions rose to 39% this quarter, up from 30% a year ago and the percentage of enterprise customers with four or more Qualys solutions rose to 20% this quarter, up from 14% a year ago;

- Cloud agent adoption accelerated with 13.9 million Cloud Agents purchased over the last twelve months, up from 8.1 million for the 12 months ending in Q2. Approximately 5 million Cloud Agents were purchased by a cloud platform customer;

- New products released since 2015 contributed approximately 23% of total bookings in the quarter, up from 14% in Q3 2017, driven by solid growth from both Cloud Agent and Threat Protection bookings; and

- We saw higher growth in the total number of orders from our SMB, SME and PCI customers. This positive result did pull our historical year-over-year average deal size increase down to 5%; however, the average deal size for our enterprise customers grew 12% year over year.

Our scalable model continues to drive industry-leading margins and generate significant cash flow. We now expect full-year operating margins to increase approximately 250 basis points:

- Adjusted EBITDA for the third quarter of 2018 was $31.9 million, representing a 45% margin as compared to 40% for the same quarter last year; for comparability purposes, Q3 Adjusted EBITDA margin would still be 44%, normalized for the impact of 606

(specifically, the amortization of commissions). In addition to the efficiencies inherent in our highly profitable operational model, this quarter our R&D expense benefited from a catch-up in software capitalization; adjusted for this effect, R&D expense would have sequentially grown as we continue to invest in research and development and in fact, are delighted with our successful recruitment efforts in Pune.

- We generated strong operating cash flow for the third quarter of 2018 of $31.6 million, a slight decline of 4% year-over-year; however, year to date, our cash flow has increased 21% versus the same period last year.

We continue to invest the cash we generate from operations back into Qualys:

- In Q3, we spent $6.7 million on capital expenditures, including principal payments under capital lease obligations; and
- We used $27.2 million to repurchase 310,815 of our shares.

We remain confident in our financial model due to our strong competitive position and leading cloud platform. As such, our Board of Directors has authorized an additional $100 million 2-year open market share repurchase program, resulting in $153.5 million of current repurchase capacity. This program will continue to minimize dilution to our shareholders:

- We have a strong current deferred revenue balance of $155.1 million as of September 30, 2018, 17% greater than a year ago.
- Current billings in Q3 were $75.4 million or 13% greater than a year ago. Our Q3 current billings growth rate was negatively impacted by a large deal that we expect to close in Q4. Our business outlook remains healthy and we are maintaining the top end of our full year 2018 revenue guidance, now in a range of $278.4 million to $279.2 million. As we have consistently communicated, we do not manage to quarterly billings and are focused on the long-term growth of our business.
- We are also raising FY2018 non-GAAP EPS guidance to a range of $1.62 to $1.64 and;
- For the fourth quarter, we expect capital expenditures to be in the range of $7.5 to $8.5 million.

We feel very well-positioned given the unique nature of our integrated IT, security and compliance Cloud Platform as well as our new groundbreaking applications which you will see at QSC.

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