# Qualys Q2 FY2017 Earnings Prepared Remarks

**REDWOOD CITY, Calif., – August 2, 2017** – Qualys, Inc. (NASDAQ: QLYS), a pioneer and leading provider of cloud-based security and compliance solutions, today announced financial results for the second quarter ended June 30, 2017.

**Joo Mi Kim, VP of FP&A and Investor Relations**

Good afternoon and welcome to Qualys' second quarter 2017 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 and an accompanying investor presentation with supplemental information are available on our website. Beginning this quarter, we are also publishing our prepared remarks on the Investor Relations section of our website to make it easier for you to follow along. With that, I'd like to turn the call over to Philippe.

**Philippe Courtot, Chairman and CEO**

Thank you Joo Mi and welcome everyone to our Q2 earnings call.

Melissa and I are delighted to report another quarter that included very strong performance on both revenues and profits driven by the continued customer adoption of the Qualys Cloud Platform and its integrated Cloud Apps. These results clearly underscore our highly scalable architecture, our true Platform approach, its value proposition and the unique advantages they bring to our customers. Therefore, we are raising the bottom and top end of both our revenue and non-GAAP EPS guidance for the full year 2017.

We are also pleased that in Q2 we saw acceleration in our Cloud Agent deployments with 3.4 million Cloud Agents purchased in the last twelve months, up from 2.6 million last quarter. Our Cloud Agent Platform, as you may recall, is the underpinning technology of many of our future solutions. We also believe that our momentum reflects our increased value and stickiness as our customers can easily consolidate an increasing number of security and compliance solutions and realize as a result, significant cost savings. In addition, with the same platform, customers can also build security into their digital transformation initiatives for global visibility and better business outcomes.

Furthermore, recent attacks like WannaCry and Petya have made it clear that the days of only scanning the network perimeter and a few critical servers are over. Enterprises now require scalability, accuracy and speed in order to identify assets that are vulnerable and ensure they are rapidly and properly remediated, which is something traditional enterprise IT and IT security solutions cannot deliver effectively, and at which Qualys excels.

At Black Hat, we unveiled new Qualys positioning and a refresh of our Logo highlighting the new unified and simplified approach to prevention and response that the Qualys Cloud Platform and its Cloud Apps uniquely bring to the market, helping customers consolidate their IT security and compliance stacks and build security into their digital transformation initiatives.

<u>In addition, at Black Hat:</u>

- We unveiled our CloudView App Framework, which gives customers the full insight across all their cloud environments – inventory, configuration and continuous view of their security and compliance postures – we showcased there its first two components: Cloud Inventory (CI) and Cloud Security Assessment (CSA). CloudView provides customers with configuration scanning capabilities and simplified workflows to assess, report, monitor and remediate security-related configuration issues based on the Center for Internet Security (CIS) benchmark and this is currently in beta.
- We also unveiled our CertView App Framework, which provides discovery and management of digital certificates, and showcased its first two components: Certificate Inventory (CRI) and Certificate Assessment (CRA), scheduled for beta in September and for GA before the end of Q4.

<u>As you may recall, earlier in the quarter at the Gartner Security & Risk Management Summit:</u>

- We showcased four disruptive new Cloud Apps in the Qualys Cloud Platform:
  - <u>First, Container Security:</u> A new cloud-based Qualys solution that enables customers to address security for containers in their DevOps pipeline and deployments across cloud and on-premises environments. This is currently in beta.
  - <u>Second, File Integrity Monitoring:</u> This highly scalable and centralized solution reduces the cost and complexity of detecting policy and compliance-related changes mandated by increasingly prescriptive regulations such as the Payment Card Industry Data Security Standard. File Integrity Monitoring is currently in beta and scheduled for general availability before the end of Q3.
  - <u>Third, Indication of Compromise:</u> This service detects activity and behavioral changes on the endpoint and delivers to customers a continuous view of suspicious activity that may indicate the presence of known malware, unknown variants, or threat actor activity on devices both on and off the network. This is currently in beta and scheduled for general availability before the end of Q3.
  - <u>Fourth, Security Configuration Assessment (SCA):</u> A new add-on to Qualys Vulnerability Management that allows customers to expand their vulnerability management program with configuration scanning capabilities and simplified workflows to assess, report, monitor and remediate security-related configuration issues based on the Center for Internet Security (CIS) benchmark.
- At Gartner, we also announced that the FedRAMP-certified Qualys Cloud Platform now supports the requirements laid out in the 2017 White House Executive Order (EO) on Strengthening the Cybersecurity of Federal Networks and Critical Infrastructure. The Qualys Cloud Platform's integrated out-of-the-box support for the Defense Information Systems Agency Security Technical Implementation Guides (DISA-STIG) and the National Institute of Standards and Technology Cybersecurity Framework (NIST CSF) reduces the time and cost for agencies to meet EO requirements.
- In the quarter, we released purpose-built content, workflows and reporting in the Qualys Cloud Platform to provide customers with continuous IT asset visibility, data collection and risk evaluation for compliance with the European Union (EU) General Data Protection Regulation (GDPR). This also helps customers with ongoing protection of personal data across global IT environments and third parties.
- Finally, we launched a 30-day free unlimited service to businesses worldwide to identify and track remediation of assets exploitable by the WannaCry ransomware virus that has impacted hundreds of

thousands of computers around the world.

This week, we were extremely pleased to announce the acquisition of Nevis Networks. This acquisition provides us with significant domain expertise in deep packet inspection (passive scanning) and also gives us the opportunity to accelerate our move into the adjacent markets of mitigation and response.

This acquisition will also strengthen our commercial presence in India, which we see as a significant opportunity for our company. We expect the transaction to close in Q3 and Melissa will provide further details.

Nevis Networks is based in Pune, India and will be integrated with our existing Pune operation, which continues to be both a competitive and cost advantage for us. In fact, we ended Q2 with almost 300 employees there.

We remain more confident than ever in our strategy because we are essential to securing the digital transformation, enabling security to be built into infrastructure, rather than bolted on. We believe the continued expansion of our cloud platform and its integrated Apps will enable us to continue to grow the top line of the business, building a strong foundation of recurring revenues, while maintaining industry-leading profitability.

With that, I'll turn the call over to Melissa to discuss our financial results in detail.

**Melissa Fisher, Chief Financial Officer**

Thanks, Philippe and good afternoon. We had a great second quarter with both revenues and profits exceeding our expectations. We believe this reflects both the strategic value of our integrated cloud platform solution and its integrated Cloud Apps as well as our highly profitable operational model. In fact, the adoption of our platform continues to increase, with the percent of Enterprise customers with three or more Qualys solutions rising to 28%, up from 22% a year ago and their average spend in the quarter increasing 24% year over year. You'll also see in our investor deck that the number of customers with annual revenues of $500,000 or more is up 40% year over year to 45 with a 47% increase year over year in combined revenues. We're also thrilled to have the Nevis team joining us.

First, on Q2 results. On the topline, total revenues in the second quarter were $55.3 million, which represents 18% normalized growth over the second quarter of 2016. There was a negative impact on our Q2 2017 revenue growth rate of approximately 200 basis points from the MSSP contract and approximately 150 basis points from FX.

We saw strong performance this quarter across renewals and upsells and we saw particular strength in Vulnerability Management including very good performance from the Cloud Agent platform. New products released since 2015 contributed approximately 9% of total bookings in the quarter. These bookings are mostly due to Cloud Agent, which includes the associated subscription to either Vulnerability Management or Policy Compliance, and include renewals that convert to Cloud Agent. We also continued to see very strong performance in Web Application Security in our SMB and SME customer base. From a geographic perspective, we saw very good results in both the Americas and EMEA; in EMEA, despite a worse currency environment. In fact, the average deal size for all new customers in those regions grew 46% and 19% year over year, respectively.

Let me now address our deferred revenue balance. Our current deferred revenue balance was $125 million as of June 30, 2017, 20% greater than our balance at June 30, 2016. Normalized for the impact from FX, our current deferred revenue balance would have grown approximately 22% year over year.

Before moving to our profitability and cash flow, I would like to remind everyone that unless otherwise specified, all of the expense and profitability metrics I will be discussing on this call are non-GAAP results. Our non-GAAP metrics exclude stock-based compensation and non-recurring items. A full reconciliation of all GAAP to non-GAAP measures is provided in the financial tables of the press release issued earlier today and is available on the investor section of our web site. Also note that certain amounts in prior periods have been reclassified to conform to the current period's presentation.

Our Q2 results demonstrate our highly profitable operational model. Adjusted EBITDA for the second quarter of 2017 was $20.4 million, representing a 37% margin as compared to 32% in the second quarter of 2016. This contributed to a 100% year over year increase in GAAP EPS and a 29% year over year increase in non-GAAP EPS this quarter. The 3% sequential decline in expenses, relative to our expectations of a sequential increase, was driven largely by lower software expenses in Sales & Marketing and more disciplined trade show spend as well as slower hiring in G&A.

In Q2, our gross margin increased to 79% from 78% in Q1. Gross profit increased by 13% year over year to $44 million in the second quarter of 2017 but our margin was down from 80% in Q2 2016. The year over year decline in margin was driven by higher depreciation from software and hardware to support continued scaling of our operations as well as increased headcount.

Operating expenses in Q2 increased by 5% year over year to $28.2 million. Research & Development expense increased to $9 million, or 13% year over year, primarily due to higher headcount. Sales & Marketing expense increased to $14.3 million, or 7% year over year, primarily due to higher headcount and increased marketing expense. G&A declined to $5 million, down 11% year over year largely due to lower third-party spend.

Net cash from operations in the second quarter of 2017 declined by 5%, to $16.5 million, compared to $17.3 million in the same period in 2016. The year over year decline in operating cash flow was driven largely by changes in the timing of orders and payments, such as customers who paid in Q2 last year and paid in a different quarter this year. Our operational model continues to be highly cash generative as reflected by our operating cash flow margin of 45% in the first half of 2017, up 900 basis points from the first half of 2016.

Capital expenditures were $8.6 million in the second quarter of 2017, compared to $4.8 million in the second quarter of 2016. Out of the $8.6 million, $4.8 million was for our business operations and $3.8 million was for our new headquarters buildout. We expect capex related to our operations in the third quarter of 2017 of between $5 and $6 million. We expect the bulk of work on our new headquarters to occur in Q3, and we anticipate the capex related to that to be another $8 to $10 million, for a total Q3 capex spend of between $13 and $16 million.

Now, turning to the Nevis Networks transaction, which is an acquisition of assets including employees, technology and certain customer contracts. As Philippe mentioned, the Nevis Networks transaction will add a team of engineers who have significant domain expertise in passive scanning and position us in the adjacent market of mitigation and response. The team is based in Pune, India, which is a low-cost geography for us, so the additional expenses do not materially change our financial outlook. This acquisition is in line with our previously stated objectives of technology that can be integrated into our platform, good cultural fit and appropriate valuation. Post close, we will be working on integrating their solutions into our platform while we continue maintaining and selling their existing products in India. We have not currently assumed any revenues in our guidance because their revenue is immaterial.

In terms of guidance, given our performance to date and the momentum we are seeing in the marketplace, we are raising the bottom and top end of our revenue guidance for full year 2017 to be in the range of $226.8 million to $228.3 million from the prior range of $225 million to $228 million. We are raising the bottom-end of our GAAP EPS range from $1.00 to $1.02. We are also raising the bottom and top end of our full year 2017 non-GAAP EPS guidance to be in the range of $0.87 to $0.91.

For the third quarter of 2017, we expect revenues to be in the range of $58.2 million to $58.9 million, representing an estimated normalized growth rate of 17% to 18% based on our current FX forecasts as well as the previously mentioned impact from the MSSP contract. We expect GAAP EPS for the third quarter of 2017 to be in the range of $0.13 to $0.15 per diluted share, while non-GAAP EPS is expected to be in the range of $0.21 to $0.23 per diluted share.

We are thrilled that first half of 2017 has exceeded our expectations and believe our new unified approach to prevention and response will position us to become the ubiquitous security and compliance platform enabling us to continue to grow the topline and expand margins.

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