Qualys Q2 FY2019 Earnings Prepared Remarks

Foster City, Calif., – July 31, 2019 – 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, 2019.

Vinayak Rao, Investor Relations

Good afternoon and welcome to Qualys' second quarter 2019 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 are available on our website. Starting this quarter, we are also providing a supplemental historical financial spreadsheet for analysts and investors. With that, I'd like to turn the call over to Philippe.

Philippe Courtot, Chairman and CEO

Thank you and welcome everyone to our Q2 earnings call.

Melissa and I are pleased to report another solid quarter in terms of revenue growth and profitability. We are also very pleased to report strong acceleration in our Cloud Agent subscriptions, with almost 24 million now. As we have discussed before, our Cloud Agent is the underpinning of seven security, compliance and IT solutions today – Vulnerability Management, Policy Compliance, File Integrity Monitoring, Indication of Compromise, Patch Management, Asset Inventory and the upcoming Certificate Management – and more to come.

In 2008, we were one of the first companies to file a cloud agent patent application and our innovation has been recognized by four issued patents and one pending continuation application. The four issued patents cover agents, including low-footprint hosted agents or host-less agents, which perform full security and compliance assessments of endpoints and cumulatively include over 100 claims of varying scope.

As previously discussed, our goal is to make our Cloud Agents ubiquitous and to that effect we announced on Monday that we will offer our Global IT Asset Discovery and Inventory App to the community as a free service so we can all regain the visibility we lost due to the fragmented nature of IT, rapid growth of IoT and move to the cloud. We will be showcasing this revolutionary offering next week at Black Hat combined with a major awareness campaign. Since the announcement, we have over 800 sign-ups and received outstanding feedback from our existing customers and industry luminaries.

In fact, global IT asset inventory is one of the biggest challenges, if not the biggest challenge, for organizations and the cornerstone of security as you simply cannot effectively secure what you do not know or see. With our free service, companies of all sizes can automatically build their global IT asset inventory across on-premises, endpoints, cloud, containers and now, mobile environments. Included in this free offering is our Asset Discovery capability (passive scanning) that provides instant visibility of any device that connects to the network. Such an integrated offering provides unprecedented and continuous visibility of both known and unknown assets.

As organizations download our Cloud Agent for implementing global IT asset inventory, we make it frictionless to subscribe to our paid Apps because no additional infrastructure is required. In addition to the paid solutions I previously mentioned, customers utilizing our free Asset Inventory will have the opportunity to subscribe to additional paid features such as synchronization with their CMDB and full life cycle software inventory.

By distributing this free solution from our platform to generate meaningful demand of our paid apps, we leverage our cloud model which is a key element of our profitable growth, driving value for both our customers and shareholders. Furthermore, this multi-product adoption naturally increases the stickiness of our platform and helps make us impenetrable by our competition, who do not offer the same breadth of solutions.

In terms of our newer solutions, we saw continued growth this quarter in customer adoption for our FIM solution as we have now added incident reporting, API integration, rule-based alerting and event correlation capabilities, as well as created a light version for those requiring compliance only with PCI requirements. In Q2, for example, a large online travel agency selected our FIM solution over a competing point solution in order to effortlessly leverage the Qualys Cloud Agents they had already deployed for Vulnerability Management and Policy Compliance and now they can have a single-pane view of vulnerabilities, configurations and file integrity. We also have a healthy pipeline in Patch Management, which enables 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.

We continued to make good progress on our other global solutions this quarter including:

- The release of our IOC 2.0 App into general availability, which provides a quantum leap in IOC detection with new detection, investigation and response capabilities that not only identify in nearly real-time known IOCs but also suspicious devices. IOC 2.0 includes:
    - enhanced attack detection using commercial file reputation threat feeds, which extend the detection of attacks often missed by anti-virus agents by integrating additional threat feeds directly into the platform;
    - a behavior-based scoring engine to prioritize response malware remediation, which factors in additional behavior attributes including file analysis, process state, and network connections to prioritize response based on how the attack is behaving in the network;
    - a new response platform microservice allowing analysts to easily configure rules for real-time alerting and actions using the same Qualys Query Language ("QQL") that they already use for 2-second search visibility; and
    - API integration with third-party SIEM, threat intelligence platforms, incident handling / response systems, security orchestration and automated response platforms, and IT Ticketing systems to automate rapid sharing of threat information with security and IT operational platforms.
- And the launch of the Qualys Canadian Cloud. The addition of this new location marks another milestone for Qualys' expanding global operations, which now includes eight locations on three continents.

We continue to believe that because of our cloud-based architecture and the priority we made to invest in the extensibility and capabilities of our platform, Qualys is one of the few companies well-positioned in the security market evolution. As we highlighted last quarter, we see a new generation of MSSP emerging to address the security needs of small and mid-sized customers with hybrid environments. That's why Coalfire Systems selected Qualys' vulnerability management and continuous monitoring capabilities this quarter to integrate into their Secure Cloud Automation Services.

We invite you to Black Hat next week to see our new technologies and campaigns. We will hold a product luncheon for investors and analysts, which will showcase the technology around our IOC 2.0 App as well as our future data lake solution. As we have discussed, current incident response solutions are quite complex and costly because they require organizations to collect disparate sets of data from multiple vendors and bring it into their SIEMs with full contextual information. We believe we have a unique advantage in this large market because we already collect, enrich, normalize and correlate trillions of data points across on-premises, cloud, and soon mobile, OT and IoT environments.

We are also pleased to welcome Gerhard Eschelbeck, a renowned cybersecurity leader, to our Advisory board. Gerhard is the former Vice President of Security and Privacy Engineering at Google and previously held CTO positions at Sophos, Webroot and Qualys. We look forward to leveraging his unique background and extensive experience as we continue to grow the Qualys Cloud Platform.

In conclusion, we are delighted to offer the community a new free prescription for security.

Accelerating adoption of our Cloud Agent unlocks a significant revenue opportunity for us and more importantly, solves painful problems for our customers including not having clean uniform data for a view of their global IT asset inventory. The breadth of our solutions across environments enables us to offer customers greater visibility, accuracy, and scalability while ultimately enabling customers to drastically reduce their overall spend.

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

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. We're delighted with our Cloud Agent adoption, which lays the foundation for future revenue growth and industry-leading profitability. Evidence of our continued progress is also reflected in our accelerated multi-product adoption and the growth in the number of customers with over $500 thousand dollars in revenues as well as our strong gross dollar retention rate, which for enterprise customers with five products is 99%. Our Q2 financial and operational highlights include:

- Revenues for the second quarter of 2019 grew 16% to $78.9 million;

- Platform adoption accelerated as the percentage of enterprise customers with three or more Qualys solutions rose to 44% from 37% and the percentage of enterprise customers with four or more Qualys solutions increased to 24% from 19%;

- Cloud Agent subscriptions accelerated to 23.6 million over the last twelve months, out of which 3.5 million Cloud Agents were purchased by a single cloud platform customer. This is up from 17.9 million for the 12 months ended in Q1 2019;

- New products released since 2015 contributed approximately 25% of total bookings in the quarter, up from 15%; and

- Our average deal size increased 3%, influenced by higher growth in the total number of customer orders.

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

- Adjusted EBITDA for the second quarter of 2019 was $33.4 million, representing a 42% margin versus 39%;

- Q2 EPS grew 42%; and

- We generated strong free cash flow for the second quarter of 2019 of $31.0 million and for the first half of 2019 of $66.3 million, representing year-to-date growth of 25% over the first half of 2018.

In Q2, we continued to invest the cash we generate from operations back into Qualys including:

- $5.9 million on capital expenditures, including principal payments under capital lease obligations; and

- $16.2 million to repurchase 183,948 of our outstanding shares. We have approximately $91 million remaining in our share repurchase authorization.

We remain confident in our model driven by our foundation of recurring revenues and expanding suite of applications:

- We're maintaining the midpoint of our FY2019 revenue guidance; our current FY 2019 revenue guidance is now a range of $321 million to $322.5 million;

- We are raising FY2019 non-GAAP EPS guidance from a range of $1.89 to $1.94 to a range of $2.03 to $2.07. We are raising our FY2019 EBITDA margin expectations to be in a range of 39% to 39.5%; and

- For the third quarter, we expect capital expenditures to be in the range of $5 million to $6 million.

We are very excited about the acceleration of our Cloud Agent subscriptions, with our innovative technology demonstrated by the issuance of four patents. Looking forward, we see additional opportunity to accelerate Cloud Agent adoption with the free launch of the Asset Discovery and Inventory app. Our Cloud Agents make it frictionless to enable many of our paid subscriptions, which provide us the opportunity to accelerate revenue growth as well as expand margins in the future. As Philippe mentioned, we look forward to seeing many of you at Black Hat for a product luncheon showcasing our upcoming campaigns and products.

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