



Qualys Q1 FY2023 Earnings Prepared Remarks

Foster City, Calif., – May 4, 2023 – Qualys, Inc. (NASDAQ: QLYS), a pioneer and leading provider of disruptive cloud-based IT, security, and compliance solutions, today announced financial results for the first quarter ended March 31, 2023.

Blair King, Investor Relations

Good afternoon and welcome to Qualys' first quarter 2023 earnings call.

Joining me today to discuss our results are Sumedh Thakar, our president and CEO, and Joo Mi Kim, 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 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 investor presentation are available on the Investor Relations section of our website. With that, I'd like to turn the call over to Sumedh.

Sumedh Thakar, president and CEO

Thanks, Blair, and welcome, to our first quarter earnings call. We're pleased to announce that we delivered another quarter of healthy revenue growth and industry leading profitability.

Q1 Business Dynamics:

A number of CISOs I've met with over the past several months continue to emphasize four key priorities: identifying all assets in their environments, prioritizing and quantifying cyber risk, finding fast and cost-effective solutions to address risk, and ensuring adequate protection against adversaries. The importance of these priorities were further reinforced by the findings in our 2023 TruRisk Report released by Qualys' Threat Research Unit after having analyzed 2.3 billion anonymized vulnerability detections. According to our research findings in the report, the average number of days to weaponize vulnerabilities in 2022 was 19, which is far less than the amount of time taken by IT teams to patch those vulnerabilities. Organizations are looking for platforms that can help them patch prioritized vulnerabilities before they get weaponized and exploited. The message is clear. Legacy technologies available in the market today that purely focus on generating more and more detections and alerts are not enough to help secure organizations. Against a backdrop of accelerating digital transformation and a cyber security skills gap, organizations require further assistance in prioritizing the most severe security findings present in

their critical assets and resolving them prior to exploitation. As CISOs look to navigate the current macro and manage increased budget scrutiny, they are recognizing the need for a holistic, risk-based approach to quantify and align cyber risk to their business objectives and thereby, be in a position to communicate effectively with their Board and C-level executives.

Platform Innovation:

For years, our mission at Qualys has been to drive continuous innovation to advance these initiatives. In doing so, we believe we've built a new security industry paradigm, which today leverages our powerful real-time data processing capabilities across more than 13 trillion data points on a natively integrated platform. Unlike traditional detection only technologies, the Qualys Cloud Platform is proactively enhancing security programs worldwide by not only detecting vulnerabilities and misconfigurations, but also prioritizing, remediating and preventing risk with over 45 million patches deployed by our Cloud Agents in 2022 alone. And, by leveraging the MITRE ATT&CK framework, we're now further flexing the power of our platform to combine a continuous, real-time view of an organization's security posture through the lens of an adversary with natively integrated, preemptive risk mitigation and prevention solutions. These capabilities, alongside our Cloud Threat Database featuring a unified threat intelligence platform of over 25 threat feeds, uniquely provide organizations with a comprehensive risk management solution to deliver quantifiable cybersecurity outcomes essential to protecting the digital infrastructure of today's companies.

Consequently, our strategic vision to consolidate the security stack has caused industry analysts to take notice. IDC recently pointed to a future of vulnerability management, which evolves into an integrated cybersecurity risk management platform. Our CyberSecurity Asset Management with External Attack Surface Management along with VMDR TruRisk and Patch Management on a single platform are key to addressing this market demand.

Of additional importance, the seismic shift in software application development and digital transformation using open-source software is resulting in a surge of software supply chain attacks. In response, we're taking our innovation to the next level by extending the power of VMDR to manage the risk of Software Composition Analysis in on-prem and cloud environments. With this extension of the Qualys Cloud Platform, security teams can automatically identify open-source software across the production environment of virtual images by leveraging the same Qualys agent for deep-scan detection and remediation spanning the entire application life cycle with high efficacy and speed. This development advances our existing Software Composition Analysis and open-source software assessment capability for DevOps teams to secure container environments in continuous integration and deployment and at run time.

In addition to this enhancement, we're also advancing our Custom Assessment and Remediation capabilities into our agent-based VMDR and Policy Compliance solutions. As Organizations develop more and more custom software, the need to expand vulnerability management from 3rd party software to 1st party software is increasing. With this initiative we are enabling customers to create their own detections for managing vulnerabilities in their own custom software across their entire environment.

And finally, we've continued to expand our coverage for public cloud providers by bringing real-time cloud asset discovery and prioritized remediation solutions on a single agent to Alibaba's cloud.

Q1 Business Update

Turning now to our go-to-market motion, Q1 remained a tough period. Despite improved upsell performance, new business was challenging as organizations continued to apply additional layers of scrutiny to spending and delay project start dates, which impacted bookings. While we expect these conditions to linger for at least the remainder of this year, consolidation remains a key theme with our customers. Given our thought leadership and continuous innovation, we are fortunate to be engaged in many such conversations. Those conversations are laying a firm foundation for future growth, and many customers are on a long-term transformation journey with us.

Existing customers continuing to invest in consolidation with Qualys' platform was evidenced in Q1 by the steady adoption of VMDR, which is now deployed by 50% of our customers worldwide. A few key seven-figure annualized bookings wins with VMDR in the quarter included two Global 200 financial institutions who chose Qualys for its ability to replace traditional siloed security tools and enhance security posture on a unified platform, and one of the world's largest health care providers that is leveraging VMDR with TruRisk to manage a comprehensive risk management platform in both on-prem environments and cloud workloads.

Beyond these wins, let's take a look at some additional examples that demonstrate how the power of the Qualys Cloud Platform translated into strategic customer wins and provided immediate value to the customer. First, with Zero Trust transformations underway, we are helping customers standardize their operations across a broad spectrum of security subscriptions. In a high six-figure annualized bookings win, a large government agency aspiring to move beyond its detection only solution further extended its use of VMDR and Policy Compliance by adding Custom Assessment and Remediation, CyberSecurity Asset Management, Patch Management, and Context XDR. This customer selected Qualys because we offer the only security and compliance stack available in the market today that utilizes both a FedRamp authorized platform and single light-weight agent to enable full asset visibility and context-aware mapping to prioritize vulnerabilities, proactively reduce technical debt, automate patching, and future proof their security architecture with high-fidelity incident response capabilities across all environments. This is also a good example of how we are benefiting from the investments we're making in the channel to drive new business opportunities.

Another marquee mid-six-figure annualized bookings enterprise customer win in Q1 was with a leading Business Services company in the Fortune 500. This customer expanded its VMDR deployment with TruRisk while adopting CyberSecurity Asset Management and Patch Management as part of an initiative to transform its IT security architecture while replacing point solutions from two vendors with a single platform. The ability of this customer to significantly enhance its security program with comprehensive internal and external asset criticality, holistic risk scoring, ticketing and automated patching across multiple environments on a natively integrated platform were all key differentiators compared to alternative legacy technologies.

With customers beginning to perceive Qualys as a leading risk management platform that consolidates multiple security point solutions, we are growing increasingly confident in our ability to drive long-term growth and gain market share. This confidence was again bolstered in Q1 as customers spending \$500,000 or more with us grew 27% from a year ago to 162.

Growing our partner ecosystem continues to be a key pillar in our go-to-market agenda. In the quarter we expanded our partnership with a leading MSSP in North America. With its platform already anchored by our VMDR solution, this partner is now launching a managed patching

service further validating our vision that organizations need help with timely remediation and not just more and more detections. This MSSP is standardizing on Qualys' automated patching solution across Windows, Linux and Mac operating systems, mobile devices and third-party applications without the need for a VPN. In addition, illustrating the fast progress we are making with our External Attack Surface Management (EASM) solution, we extended our relationship with a leading cyber insurance company, which is now ingesting our EASM intelligence feed to continuously assess risk for adaptive cyber insurance for their customers.

Furthering our efforts to remove friction in the sales cycle by helping customers accelerate their cloud transformations and consolidate their security stacks, we've introduced a new adaptive subscription model for organizations to extend their existing VMDR deployments into cloud and container environments for CSPM and CWPP through our TotalCloud solution. The early feedback we're receiving from customers for this model is quite encouraging and we're looking forward to early customer adoption in the current quarter.

In summary, it's our view that during times like this, the best companies continue to innovate, focus on customer success and emerge stronger than before. Looking beyond the short-term, we believe the powerful combination of our cloud-native platform and frictionless go-to-market motion position us well as the fundamental, holistic risk management platform of the future. Throughout the balance of this year, we will continue to focus on executing our strategic vision, driving customer success and expanding our lead over the competition with a proven approach to balanced growth and profitability.

With that, I'll turn the call over to Joo Mi to further discuss our first quarter results and outlook for the second quarter and full year 2023.

Joo Mi Kim, Chief Financial Officer

Thanks, Sumedh, and good afternoon. Before I start, I'd like to note that, except for revenues, all financial figures are non-GAAP and growth rates are based on comparisons to the prior year period, unless stated otherwise.

Turning to first quarter results, revenues grew 15% to \$130.7 million with channel continuing to increase its contribution, making up 43% of total revenues compared to 41% a year ago. Revenues from channel partners grew 18%, outpacing direct, which grew 13%. By geo, growth in the US of 16% was approximately in-line with our international business, which grew 15%. Looking ahead to the balance of 2023, we expect our US and international revenue mix to remain at roughly 60% and 40%, respectively.

In Q1, we saw continued strength in customer dollar retention and upsell in line with expectations with our net dollar expansion rate on a constant currency basis at 109%, flat from last quarter, but down slightly from 110% last year. While there remains room for improvement from smaller customers spending less than \$25,000 with us, we are pleased with the strong revenue growth of 18% from larger customers.

In terms of new product contribution to bookings, Patch Management and CyberSecurity Asset Management combined made up 10% of LTM bookings and 16% of LTM new bookings in Q1. We attribute this success to an increasingly complex threat environment that highlights the relevance of the Qualys Cloud Platform to holistically assess, manage and remediate risk.

Reflecting our scalable and sustainable business model, Adjusted EBITDA for the first quarter of 2023 was \$58.7 million, representing a 45% margin, compared to a 48% margin a year ago. Operating expenses in Q1 increased by 20% to \$54.1 million, primarily driven by the growth in S&M investments, including higher headcount and related costs. During the remainder of 2023, we believe it's prudent to take an opportunistic approach in executing against our investment plan while not losing sight of the importance of optimizing our prior investments to drive long-term profitable growth.

EPS for the first quarter of 2023 was \$1.09, and our free cash flow for the first quarter of 2023 was \$62.8 million, representing a 48% margin. In Q1, we continued to invest the cash we generated from operations back into Qualys, including \$4.0 million on capital expenditures and \$66.6 million to repurchase 584 thousand of our outstanding shares. As of the end of the quarter, we had \$187.9 million remaining in our share repurchase program.

Now, let us turn to our guidance. Starting with revenues: For the full year 2023, we are reaffirming our revenue guidance range of \$553.0 million to \$557.0 million, which represents a growth rate of 13% to 14%. For the second quarter of 2023, we expect revenues to be in the range of \$135.2 million to \$136.2 million, representing a growth rate of 13% to 14%. This guidance assumes no material change in our net dollar expansion rate in 2023 but continued challenges in new customer growth. We believe our value proposition remains strong with solid demand from our existing customers but anticipate the current macro environment will moderate returns in 2023 despite having increased our sales and marketing headcount by over 20% in 2022.

With that said, given the long-term growth opportunities ahead of us and our industry-leading margins implying further room for investment, we will continue to responsibly invest in operations, people, and systems while recognizing the importance of optimization. As a result, we continue to expect full year 2023 EBITDA margin to be in the low 40%'s with full year EPS in the range of \$4.13 to \$4.28, up from the prior range of \$4.10 to \$4.18. For the second quarter of 2023, we expect EPS in the range of \$0.98 to \$1.03. Our planned capital expenditures in 2023 are expected to be in the range of \$15 to \$20 million and for the second quarter of 2023, in the range of \$3 to \$5 million.

Consistent with prior guidance, for the remainder of 2023, we intend to align our product and marketing investments to focus on specific initiatives to drive more pipeline and support sales in response to the current macro conditions. In doing so, we plan to prioritize investments in sales and marketing as well as related support functions and systems over our investments in engineering. As we endeavor to sharpen our execution by focusing on sales and marketing enablement and productivity, we believe we will be able to drive wallet share and long-term returns while balancing growth and profitability.

In conclusion, in Q1 we delivered healthy top line growth and industry-leading profitability. With our comprehensive risk management solution garnering industry attention and delivering immediate time to value for our customers, we are confident in our ability to deliver on our growth opportunity long-term while investing responsibly to maximize shareholder value.

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