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CORPORATE PARTICIPANTS

Joshua Siegel *CyberArk Software Ltd. - CFO*

CONFERENCE CALL PARTICIPANTS

Melissa A. Franchi *Morgan Stanley, Research Division - VP and Research Analyst*

PRESENTATION

Melissa A. Franchi - *Morgan Stanley, Research Division - VP and Research Analyst*

Hi, everyone, I'm Melissa Franchi. I cover the Security Software space here at Morgan Stanley. Thank you, everyone, for coming.

Before we start, I'm just going to read this disclosure. Please note that all important disclosures including personal holding disclosures and Morgan Stanley disclosures appear at the Morgan Stanley public website at www.morganstanely.com/researchdisclosures or at the registration desk.

So today I'm very happy to introduce the CFO of CyberArk, Josh Siegel. Thanks for coming.

Joshua Siegel - *CyberArk Software Ltd. - CFO*

Thank you, Melissa. It's great to be here.

QUESTIONS AND ANSWERS

Melissa A. Franchi - *Morgan Stanley, Research Division - VP and Research Analyst*

So you're coming off a very stellar year for CyberArk. We saw growth accelerate 2018 versus 2017, and it sounded like there was a number of drivers that drove that acceleration. It sounds like, first of all, it's a better market environment, more awareness for the need for privileged access security. You have a better competitive environment, you've made some changes to the product portfolio and to the pricing strategy. Can you maybe just start with what is driving the greater awareness of privileged access security? Because it's a market that's been around for a while, but it does seem like we're maybe hitting an inflection point where enterprises are starting to better prioritize that in terms of their overall IT security budget? And what's driving that?

Joshua Siegel - *CyberArk Software Ltd. - CFO*

Yes. Sure. Well, you're absolutely right, actually the industry and the knowledge and the acceptance of where privileged access security plays within an enterprise security strategy has really raised itself several notches, not just in the last year, but really over the last several years. And I think it's really contributed to a lot of factors. First and foremost, when chief security officers are now looking at their strategy positioning, it's really around a post-breach strategy. So it's already assuming that the network can be breached, and what do we do to ensure against network takeover? And when they start talking about network takeover, then really one of the first things that pops up are what are you doing around privileged access, because that's really the last stop and when the -- if the hackers and the attackers get to the privileged access points then that really is a very, very dangerous spot to be for the enterprise and really it's kind of the last mile before the takeover.

I think the other thing that has really helped with the awareness in the industry generally is that the industry analysts are coming around and talking about privileged access security as really a top 5 or even a top 3 priority. I think, just almost just under a year ago, Gartner in their symposium put up on their screens their top 10 issues that security experts need to think about for the enterprise, and at the top of that page was privileged access security. I think if you look at the SANS report, where 3 or 4 years ago, it was in the teens. It's now in the top 5 when you look at privileged

access security. So I think when you analyze all the attacks that have happened and you realize that in 99% of the cases they accessed administrative credentials, and then you look at kind of the secular industry analysts who are talking about security and they're also putting -- listing it as always a top 5 or a top 3 priority. And then you just see the growth that CyberArk has done really since it's gone public in 2014. And then -- and also as well as our competitors in terms of money being invested in them, it really has created a much stronger awareness for our products.

Melissa A. Franchi - Morgan Stanley, Research Division - VP and Research Analyst

Got it. Okay. Historically, you've focused mostly on large enterprises and you have a presence in banking financials are larger verticals for you. Well, talk about your expansions to the mid-market, but just first focusing on the enterprise opportunity. How much more run rate do you have within the Fortune 500? And then when you're going into -- how the relationship with the enterprise, is it mostly greenfield? Or is it competitive displacements?

Joshua Siegel - CyberArk Software Ltd. - CFO

Yes. So if we think about the Fortune 500, we have just over half of them. So we have another half to either go after for greenfield or take from our competitors. And it's funny even as we get -- we go after these large enterprises, we're seeing still that 70% or 80% of these new customer add-ons are greenfield opportunity. And when I talk about greenfield opportunity, it's not necessarily that they didn't have anything, but they didn't have a privileged access security strategy. And so when we came in, it was really, you are going to be our privileged access security -- strategy. And they may have had some of our competitors for bits and pieces or certainly they may have had something homegrown or lots of processes and controls, but we still see that as a greenfield opportunity because they're looking at now as we just talked about earlier, we need a privileged access security because that awareness is now there. And now, it's like, okay, now who am I going to use as my vendor of choice for that? And then they look at our competitors and they look at us, and when we go in and win those new customers, even in the Fortune 500 today, frequently it's going to be a greenfield opportunity. And then if we think about what else we're going after is our internal install base. So of the 250 Fortune 500 companies we have, most of those are using maybe only a portion of our products, and certainly not fully deployed. If we think about all of our 45 -- almost 4,500 customers, we still feel like in that customer base alone, we have over \$3 billion worth of available market to go after. And most of it is coming from, if not the Fortune 500, certainly the Global 2000, because those are going to be our largest vendors.

Melissa A. Franchi - Morgan Stanley, Research Division - VP and Research Analyst

Got it. Okay. I want to stick to competition, this is sort of in line with my prior question in terms of competitive displacement. One of the factors that you cited on the most recent earnings call, was just a more favorable competitive environment with some of your competitors getting acquired and some questions on the long-term trajectory of those businesses. Can you talk about the extent to which that was an enabler of better growth for you in Q4? Or is that still maybe more on account for '19?

Joshua Siegel - CyberArk Software Ltd. - CFO

Yes, I think overall, and really from the beginning, we set this layer, privileged access security. We kind of created this later when we IPOed in 2014. And we've been the leader in this space really from the beginning. So I think when we saw -- what we saw in 2018 in some of the reshaping of the competitive map, that was -- I don't believe that, that was a major contributor for our growth for 2018. I think the leading -- the strategic moves that we made internally contributed, I think, the whole industry knowledge and awareness have contributed. When we look at now though going into 2019 and 2020, I think, clearly we've continued our gap, increasing our gap with our competitors, and we expect that some of our -- some of them that you mentioned may even go away and focus on other things. And I think the competitors that have been invested in by private equity, we see them continuing and to certainly be real competitors.

And what CyberArk will continue to focus on which really has allowed us to establish our leadership position from the get-go is around innovation and security. And CyberArk founded by its current CEO and Founder, Udi Mokady, it's about being a leading cybersecurity company and about

being innovative and having the best technology for preventing IT network takeover. And I think we respect the competitive field, but I think, we're the leaders in really choosing to take the path of innovation in cybersecurity as the reason for why we should be the vendor of choice.

Melissa A. Franchi - Morgan Stanley, Research Division - VP and Research Analyst

That makes sense. Shifting to the new pricing model that you introduced at the beginning of 2018, you've come out with a new per user bundle and you did talk about how that was aiding sales cycles or starting to aid sales cycles. And I believe you said in Q4 that it was -- over 60% of your deals were on a new pricing bundle. Can you maybe talk about the extent to which that has helped sales cycles? And when you started to rollout that bundle, was there any sort of -- any surprises in terms of customer buying behavior that was the result of the new pricing model?

Joshua Siegel - CyberArk Software Ltd. - CFO

Yes. So I think first to be clear, we had about -- we had 60% of the new -- of the total license sales were with our new pricing model. It was just about 70-plus percent of the new license revenue of new customers were on the new pricing model and then about 40-or-so percent of the existing customers. And we really saw that not necessarily reduce the sales cycle because we are still pretty much a 6 to 9 month sale cycle transaction, but it really created a much more fluid sales motion and sales flow for that 2 or 3 quarter period, because there was a lot less discussion from the customer of how do I spend my budgeted proceeds. Do I involve more users? Or do I monitor more IT infrastructure? Or do I do more analytics to check for anomalous behavior? This way they were able to just really focus on, this is my user exposure and I don't need to count my IT infrastructure and so forth. And I think that, that whole point of simplification for the customer was really good in a couple of ways. One is that it allowed us to talk about the positioning and this whole strategy that they wanted to do and not talk about which pieces of it. And also with our existing customers and with new customers, it was that we listen to them because one of the complaints that we were getting was actually your pricing is too complicated. And the fact that we were able to come back to them with a solution that made it easier for them, I think, that was very much appreciated that the vendor was listening to them.

Melissa A. Franchi - Morgan Stanley, Research Division - VP and Research Analyst

Have you seen any impact in terms of ASPs from the new bundle?

Joshua Siegel - CyberArk Software Ltd. - CFO

So we haven't seen any impact on new customer business. It's pretty much been in the range of where we've seen it over the last few years. What we have seen is, I think, it's been a generator also for add-on business because we've seen customers saying, "You know what, now I want to actually upgrade my existing user base to include the rest of the bundle." And it was, I think, it's been a nice generator for being able to create upsales.

Melissa A. Franchi - Morgan Stanley, Research Division - VP and Research Analyst

Got it. Okay. And one of the other initiatives that you've discussed throughout '18 is sort of investing more heavily for the mid-market opportunity. So you released a solution for MSSPs, you now have the CyberArk Privileged Cloud, you have the ability to deploy on AWS. Can you maybe just, for us to start we'll get into all those aspects but to start, can you talk about why you think the mid-market is an interesting opportunity for you, particularly since it seems like there's plenty of runway in the enterprise space?

Joshua Siegel - CyberArk Software Ltd. - CFO

Yes. So I think what you finished there is a great point. First of all, and I'll make it clear here, the enterprise space is really where we're going to see the big growth opportunities for CyberArk certainly in 2019. And when you think about our business for 2019, the heavy focus and investment on everything we do is going to be really around still the large enterprise for our existing customer base and for the new customers. However, we do

see and a part of it goes back to your first question about the fact that there is just more awareness of the problem and awareness of the strategy, we are seeing that the mid-market is a bona fide opportunity for us. And in fact actually even though for the last many years we've always kind of fished for the large enterprise, if you look at our customer base, a quarter of them are what we would call mid-market already today. So when we look at our first kind of what we would call targeted investments into this space it is really first around setting key -- kind of setting the new market -- the new sales teams that are approaching the mid-market. It's a bit of a different sales motion, it's a different muscle that the CyberArk would like to use and develop. And so that's one of the things that we'll be looking at in 2019, and we've actually carved out a team in Europe and in the United States to start focusing on that mid-market. We do have some competitors, who have come from that space who have built products kind for the small and medium business, and of course, would also like to go up market, so clearly this is something important for us to also be proactive in being able to go down market.

Melissa A. Franchi - Morgan Stanley, Research Division - VP and Research Analyst

So you talked about the sales strategy around the mid-market but to what extent do you -- some of the newer products like the CyberArk Privileged Cloud help you gain traction in the mid-market? And since you've released it, I think it was in the summer of this year, have you seen any meaningful traction to-date?

Joshua Siegel - CyberArk Software Ltd. - CFO

Right. So we really have a -- the first thing we did and we already did this at the beginning of last year in order to look at the mid-market and get our feet wet there is around our MSSP product, which you mentioned. And we have several partners also in Europe and in the United States, who are using CyberArk in their managed services that they are selling to enterprises. And those enterprises are typically are going to be more downmarket in a midsized market. And we have -- and we're developing those relationships with these MSSPs going forward. And the other thing that we did and you alluded to it is releasing our CyberArk Privileged Cloud product. So it's really the first time that we're selling our Core PAS capabilities as a service. We expect that early adopters of that will be coming from small and medium enterprise space. I would say, we have our first early adopters going into 2019. We still really see that, first of all, like I said earlier, this is a large enterprise marketplace. And we really see enterprises still mostly interested in owning the license and using it, and even if they own it to put it in their cloud, and which is frequently the case, where they have a cloud for a strategy and they're actually buying CyberArk, but deploying it from their Amazon or Azure cloud.

Melissa A. Franchi - Morgan Stanley, Research Division - VP and Research Analyst

Got it. So we've seen a few or maybe one notable peer in the security space who has made a more aggressive shift to subscriptions or has alluded to more aggressive shift in 2019. So it sounds like you are doing maybe a soft launch of your Privileged Cloud, it's not necessarily a transition so to speak, but what are your thoughts on may be more aggressively moving to a subscription model versus the license and maintenance model?

Joshua Siegel - CyberArk Software Ltd. - CFO

Yes. So last year, we did between our SaaS and our term-based license business that we had, it was about 3% of total revenue -- total license revenue and about 6% of -- 3% of total revenue and 6% of total license -- of license revenue, which was pretty similar to what it was as well in 2017. And I say SaaS and term based license, our SaaS product is basically coming from our Endpoint Privilege Manager of SaaS, which we sell as both a perpetual or a SaaS version and to be honest about it's coming in about half and half on demand and we really leave it up to the customer to decide. And then we do have already for several years, we've allowed our enterprises to buy our Core PAS as a term-based license, and -- because some customers have always wanted it that way and that's kind of the last couple of percent. I think as we go forward, certainly when we look at the downmarket and we look at the mid-market, new customers, we're going to be more proactive with going to them with a quote on a term-based license because we think that, that will be appealing to them. They're less interested in total customer ownership and more interested in kind of the immediate impact of cash or the immediate impact of what they're doing in year 1 and year 2. And when we think about our guide and our forecast for 2019 though, we still don't anticipate that term-based license in SaaS product will be more than 5%. It will be similar to what it was last year, maybe a tad more. I think as we look forward and go out multiple years and our CyberArk Privileged Cloud product gains traction, our MSSP gains traction

and we kind of have developed that muscle with the new market, we can see that type of recurring revenue grow. But we're, as you said, and maybe more appropriately, it's kind of a soft launch because at the end of the day the customer is really still coming to us with wanting it the way we've been delivering it over the last many years.

Melissa A. Franchi - Morgan Stanley, Research Division - VP and Research Analyst

And the sales force was not incented to sell subscription over the license?

Joshua Siegel - CyberArk Software Ltd. - CFO

Actually, this year we actually have certain pieces of our sales teams, which will be going to midsized customers with term-based license quoting. They will be compensated in a way to help neutralize them against the fact that there will be smaller sales deals. So they -- and because we are a hybrid model, there is no way getting around it even under any circumstances, we have 4,500 customers, who have bought already in a certain way. We will always be kind of -- sales people will always have kind of both ways and we want to keep them neutral. So we're a bit indifferent on how they want to consume, we just want them to consume, and we want them to consume a lot.

Melissa A. Franchi - Morgan Stanley, Research Division - VP and Research Analyst

Right. Okay. Shifting to products outside of the Core Privileged Access Security. Conjur and Application Identity Manager is still 10% of license revenue, I believe. And -- but you didn't know that there are participant in a lot of the large deals, 6 out of 10 large deals in much recent quarter. Can you talk about the opportunity around securing DevOps and how it's synergistic with the rest of the portfolio? Is it selling into the same end buyer?

Joshua Siegel - CyberArk Software Ltd. - CFO

Yes, you're absolutely right. We did, last year our AIM contract business together was 10% of revenue. It really was a -- moving into the DevOps pipeline was really critical for us in terms of -- we already had our leadership position in application credential security, and -- but what we saw already years ago was that customers were moving into web-based applications in the cloud, but also into the DevOps processes where our Application Identity Manager, while it secured credentials was not really a fit for the speed and the agility that DevOps -- that developers really needed to have in order to secure the credentials that they were basically spinning regularly on a daily basis within their DevOps process. So for us, it was actually like a very natural fit to be able to have Conjur added into -- it's kind of the next step to our -- and in fact, this year we're really only positioning what we're calling the AIM product and we're not even positioning a Conjur and AIM product, it's just going to be one SKU that will be able to be used for the different credential purposes.

In terms of the market opportunity, this is something that CyberArk is -- it's really important to CyberArk because we talk about securing users and we also want to be part of the digital transformation of what enterprises are going through. And it's -- not only are they moving from on-prem to the cloud, but they're also -- we're just creating a whole new line of different types of vulnerabilities and credential security needed, but they're also now because of the cloud environment and their transformation, they're also being able to create new ways of development -- of developing applications. And we want to continuously be part of that transformation by enabling them to go through it and not slowing them down. And the DevOps pipeline, the DevOps opportunity is really as big as all these enterprises going and developing more and more of their application using these processes, and it extends us to not just the IT administrators but now extends us to developers. And I think someone this morning that who was in the meeting with us, threw out the number of like 20 million developers around the world or something like that, I don't know if it's true, but that's what an investor told me.



Melissa A. Franchi - Morgan Stanley, Research Division - VP and Research Analyst

Cool. Got it. Okay. And so is it fair to assume -- it sounds like your Core business is growing pretty healthy, but if we think about what's going to maybe outpace the overall revenue mix, is it fair to assume maybe DevOps could outpace the rest of the portfolio?

Joshua Siegel - CyberArk Software Ltd. - CFO

Yes. I think at this point with our business growing as fast as it is, we're happy with that piece growing along with the business. It's certainly at some point could be an accelerator to helping the business even grow faster, but all the time we see that the Core PAS organic opportunity is there. We feel like that we want to make sure we don't lose sight of that. And if we actually look at the overachievement that happened in 2018, it came from the Core PAS.

Melissa A. Franchi - Morgan Stanley, Research Division - VP and Research Analyst

Okay. Interesting. I'm going to ask one question on margins, then I'll open it up to the audience for any additional questions. So in addition to the top line, you also posted upside to margins in '18, 26% operating margins, which has moved up meaningfully from '17. And you're already sort of outpacing what was laid out as like medium-term operating margin targets at your last Analyst Day. You're guiding for 23% next year as you're sort of investing for growth. It looks like -- can you maybe just talk about where you are targeting your incremental investments and we'll start there.

Joshua Siegel - CyberArk Software Ltd. - CFO

Okay. Yes. We're definitely targeting -- it's going to be split pretty equally between about 1% -- a little over 1% on sales and marketing extra, and another 1% on R&D. And then kind of just under 1% related to cost of goods, which is really around the services side of the arm and training within the cost of goods side. So when you talk about sales and marketing and that's really pure investment, we need to -- if you look at 2018, we only grew our sales and marketing headcount by I think 10%, but we grew at 40% since 2016, and that was the purpose. So as we were -- as operators of the company, we really felt like we needed to get more productivity out of our sales and marketing in 2018 after the investment we did in early 2017, and we did. So now again, we're going to kind of reaccelerate there some of the investments in sales and marketing, because when we talk about our investment in sales and marketing and also for R&D for that matter, it's not a 1 year vision, it's really a 2 to 3-year vision. Our sales people take 9 months to ramp up, and we really start to get the full production after into the second year. And the same with R&D. If we think about what was successful in 2018, it was one of those big points was the Version10, that was the version that we started to invest heavily in behind the scenes already in 2016 and 2017. So those are the types of things now we need to be thinking about, and with the movement so quick in the IT space and on the attackers coming at us, we have to really fire on a lot of cylinders in the backrooms.

Melissa A. Franchi - Morgan Stanley, Research Division - VP and Research Analyst

Got it. Okay. Let me just see if there is any questions in the audience.

Unidentified Analyst

Yes. It feels like at least from this seat, Microsoft over the last year has been pushing more identity management around their Active Directory. Just talk about if that's competitor or separate lanes, and how that relationship has involved?

Joshua Siegel - CyberArk Software Ltd. - CFO

Yes, I mean, just in general, identity management is a separate lane. We kind of view -- we have Privileged Access Management in our swim lane. There is identity governance, another swim lane. And then there is identity access in a third swim lane. So any activity that any of those key players



are doing on identity management is really in a separate swim lane, and it's really from the standpoint of we are securing the IT administrators, we're not just managing them. And it's also the idea that what CyberArk is about is that they're privileged and they have access to basically and ability to -- if they're compromised for IT takeover. And it's not just about managing the identity, it's also about securing those -- it's vaulting and securing those identities, it's monitoring them, it's analyzing them on an online basis.

Melissa A. Franchi - Morgan Stanley, Research Division - VP and Research Analyst

Any additional questions?

Unidentified Analyst

Can you talk about your relationship with ACTA, and just any sort of like co-sale or anything, are they bringing you guys to their deals and vice versa?

Joshua Siegel - CyberArk Software Ltd. - CFO

Yes. Absolutely, ACTA and the players as well in the identity management space, all the lead players in the identity management space and in the governance space for that matters are key partners of ours in what we call C3 Alliance. And we frequently are doing joint marketing programs with them. We don't have formal go-to-market in terms of sales teams going together, but it's usually one of the first questions out-of-the-box either for them, I believe, and certainly for us when we're in an enterprise is how do you work out-of-the-box with our governance solution or with our identity management solution whether it's ACTA or somebody else. So -- and it's critical that we're able to say and we spent -- and we actually do invest to ensure that we're able to work out-of-the-box with those players, and we feel like we have a very strong partnership with them.

Melissa A. Franchi - Morgan Stanley, Research Division - VP and Research Analyst

Okay. One last question on margins. Just thinking about beyond '19, you definitely gave a lot of good detail on where you're investing, but you did lay out longer term targets at your Analyst Day, 27% to 31% operating margins, which is not too far from where you were in '16. So do you have any updated views on the timing of when you reach those longer term targets? And why can't it go higher?

Joshua Siegel - CyberArk Software Ltd. - CFO

So I think, on the timing, it's really when we start to see that the growth opportunity is not going to be 20-something percent. When the market opportunity is not going to be a high number, and then we -- and then it's about, well, how do I return to the shareholders, and it's going to be around leverage. And in terms of where can we get to? It's going to be really a focus on sales and marketing dollars. And I think that we've been efficient with our sales and marketing dollars to-date, but certainly, when we don't have to bring on 10%, 15%, 20% new sales and marketing people at the beginning of every year, that will be only productive 12 months out, that's going to be a big factor on being able to reduce the leverage. Can we go higher than 31%? Right now, I think we'll stick with what we said.

Melissa A. Franchi - Morgan Stanley, Research Division - VP and Research Analyst

Okay. Well, we'll wrap it up there. Thank you very much, Josh, and thank you, everyone, for coming.

Joshua Siegel - CyberArk Software Ltd. - CFO

Great. Thank you.



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