

THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

CYBR - Cyberark Software Ltd at Morgan Stanley Technology, Media & Telecom Conference

EVENT DATE/TIME: MARCH 03, 2020 / 12:55AM GMT



CORPORATE PARTICIPANTS

Joshua Siegel *CyberArk Software Ltd. - CFO*

CONFERENCE CALL PARTICIPANTS

Gregg Steven Moskowitz *Mizuho Securities USA LLC, Research Division - MD of Americas Research*

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

PRESENTATION

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

I'm Melissa Franchi, cybersecurity analyst here at Morgan Stanley. I'm very happy today to have Josh Siegel, CFO of CyberArk. Thank you, Josh. Before we get started, let me just read this disclosure. Please note that all important disclosures, including personal holding disclosures and Morgan Stanley disclosures appear on the Morgan Stanley public website at www.morganstanley.com/researchdisclosures or at the registration desk.

Great. Okay. With that, maybe we can start with a high-level question. We're just coming off the back of the RSA Conference last week. One of the themes that we've talked about in our own research is really how identity is becoming an increasingly important part of the security architecture. And you obviously play in some aspect of sort of identity management.

QUESTIONS AND ANSWERS

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

Can you talk about why it's becoming increasingly important? Where you fit into that theme? And what you're seeing in terms of privileged account security and prioritization of security budget?

Joshua Siegel - *CyberArk Software Ltd. - CFO*

Yes. Great. And first off, thanks, Melissa, for having CyberArk here present at the conference. And it's been a great day so far. So yes, you're right. We had RSA here. We were just here a week ago. We had a busy week. And where CyberArk plays is on the inside of the network. So essentially, we know that it's been really proven to be easy for attackers to get inside the network through phishing attempts and basically have access already to the endpoint pretty quickly. And so what CyberArk is about is basically thinking about credential theft, lateral movement and least privileges and abuse of those credentials.

So CyberArk and thinks about it also from a human perspective, human credentials and also from an application perspective, from the application credentials. And we're -- CyberArk is there to do is to secure the network against takeover. For attacks to basically get to an endpoint or to get to certain user bases is malicious, but it's not super damaging to the network. To the extent that it gets to, what we call, privileged user or an administrator, then it has access to start changing things within the network, compromising other credentials and basically laterally moving through the network to eventually get to a point where we say it owns the network and could do basically whatever it wants in terms of setting up new policies, setting up new users, fake users and taking out information. So we're focused, first and foremost, for trying to protect those administrators from their credentials being stolen in a way that they then can't laterally move within the network. And then on -- for those -- and for non privileged users, for their privileges to be limited and not to be abused.



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

Got it. That's a helpful overview. On the past few earnings calls, or I guess, over the past year or so, you've talked about how CyberArk benefits from the trend towards digital transformation. Can you talk about how CyberArk plays into the theme of DevSecOps, if you do, and what products are specifically tailored to that opportunity?

Joshua Siegel - CyberArk Software Ltd. - CFO

Yes. So absolutely. I mean, all organizations today are in some form of digital transformation. They either are thinking about how they're moving assets to the cloud or they've already started or they've already done it. And you mentioned the DevOps piece, the DevOps piece is around the developing process as part of the digital transformation. And there's really 2 areas, there's the human area and the application area. When you think about the human area, you now have developers accessing the cloud, cloud administration, web applications. And those are secured than in our core PAS, at our Core PAS products, which is 80% of our license revenue. And then when you think about on the application side, when you think about all the computer CI/CD tools. So every time you're interacting between those tools, secrets are being created at the developer's level. And that's where our Application Access Manager comes in. That's where you basically -- those tools will then access, make a call to our vault and where the secrets are being secured in order to interface from one tool to another tool. And DevOps is -- uses -- DevOps processes are using a host of CI/CD tools in its methodology.

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

Okay. We'll dig into that in a little bit, but just shifting to the core PAM or PAS opportunity, Privileged Access Security. Historically, you've focused on the large enterprise space, and you are the leader, I would say, probably by far in that market opportunity. There's a key debate on how much more greenfield you have in the large enterprise space, how much growth is left in the market. Can you talk about the extent to which you can still continue to grow within the enterprise space? Or do you need to move down mid-market, low-end enterprise.

Joshua Siegel - CyberArk Software Ltd. - CFO

So CyberArk generally sweet spot is to sell into the medium and large enterprise. It's where our -- we've developed our products for, it's where we've been able to enjoy really a 35% CAGR over the last 10 years was really going into the medium and large enterprise space. Today, we have 50% of the Fortune 500. We have 30%, more than 30% of the Global 2000 companies is really is an indicator, as you said, as our leadership position in the enterprise space. However, the enterprise space goes well beyond the Global 2000. And we -- it's still very much a greenfield opportunity. When we look at our new customer acquisitions, last year, we had 850 new customer acquisitions, and we still see over 60% of them being in a greenfield opportunity, really, almost 65% being a greenfield opportunity. And the other -- so from a -- as we go beyond the Fortune 500, we see still a very large opportunity in that enterprise space in the Fortune 5,000 and beyond. We have 5,000 customers today. We believe that we look at 50,000 enterprise organizations. And of course, some of them start to go into mid-market, mid-enterprise and smaller enterprise. But nevertheless, enterprises with complex IT infrastructures. And the other piece of the room or the market that we have with the large enterprises that even if we think about the traction that we have in the Fortune 500 and in the Global 2000, the largest enterprises in the world, we're still well under 50% deployed in those organizations. So that's also with our core Privileged Access Security, our core PAM software as well as with -- when we start thinking about it at the application credential level in our Application Access Manager or at the Endpoint Privilege Manager. Today, one of the -- our newest product that we'll be going into though I'm sure we'll -- maybe we'll talk about later. Also, which is for the large enterprises is remote access to those enterprises.

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

Right. Yes, we certainly will. But just staying on the theme of continued growth within the core market opportunity, there has been some shifting competitive dynamics within the industry. Obviously, CA is a competitor for you. But then with the acquisition of Broadcom, it potentially could create some disruption, perhaps, it already has. Can you talk about the extent to which you've been benefiting from share gains from CA? Or -- and has that accelerated on the back of the Broadcom acquisition? Or is that still on the come?



Joshua Siegel - *CyberArk Software Ltd. - CFO*

I think that we've always competed well against CA. So even when -- before the acquisition of CA, we saw them a lot, and they were a true head-to-head competitor for new customers. We did compete and win our fair share. Now with the acquisition of CA, we definitely -- we do not see them with new customers. So we have -- we basically are now more competing with some of the private vendors for those new customers. We do see, though, that CA continues to manage their existing installed base, which is significant. One of the things that we see is that we expect, at some point, that installed base will want to refresh, that installed base will want to scale out and move, and they're also part of a digital transformation, and they're going to have new requirements. And I think at that -- I think that's going to really present to CyberArk a nice opportunity for getting into their current installed base. And we see that ahead of us still.

Gregg Steven Moskowitz - *Mizuho Securities USA LLC, Research Division - MD of Americas Research*

Okay. Important. Okay. Shifting to the product portfolio. Let's start with a high-level question. You all have come out with a number of SaaS products over the past year or 2 years. You know have the Privilege Cloud, Endpoint Privilege Manager is offered as a subscription and you have Alero. Just at a very high level, can you talk about how these new subscription products have opened up new opportunities for CyberArk? Does it allow you to address a new customer base that you haven't before? And what -- of the cloud or subscription products, what do you think is -- holds the most opportunity?

Joshua Siegel - *CyberArk Software Ltd. - CFO*

Yes, absolutely. I think that when we look at -- if we look at our 3 SaaS products kind of in order of magnitude, we have our Endpoint Privilege Manager, which is something that we've been selling for several years. We've always offered it both as an on-prem or as a SaaS offering. And as we've moved into the end of 2019, more than 60% of that business has been coming from SaaS as opposed to, if we thought about it 3 or 4 years ago, where it was 40% to 50%. And we anticipate going forward that it will likely be -- keep growing towards being SaaS only. And any time now that we're thinking from a SaaS, we have the SaaS offering, it's entrenched. We have the strong leadership position in the marketplace. We do anticipate that they're opening up new markets within our existing installed base because they're looking. Many of our companies now are moving more and more applications to the cloud and knowing that they can come to us for Endpoint Privilege Manager as a cloud offering, even at the large enterprise space, is going to be, I think, significant to them. So we see that as significant. I think the next area that gets us into a different market space is the Privilege Cloud offering, because that's taking our Core PAS offering and allowing it to be consumed as a third-party hosted software. And really where we see that being instrumental, certainly, in the next 12 to 24 months is more mid market. It's more what we call commercial kind of mid -- medium enterprise and small enterprise. And we think about small enterprise at \$500 million to \$1 billion of revenue and then kind of moving up from there into the medium enterprise. And that's an area where, again, I mentioned earlier today, our sweet spot has always been medium enterprise, large enterprise. But we're seeing now inbounds from the small and medium enterprise saying, okay, what do you have that I can consume in privilege access from the cloud? So we'll -- this opens up a new opportunity downstream there. When we think about our Alero product, which is about accessing our -- the Core PAS across any vertical across any enterprise, small, medium or large, that's going to be completely incremental, because now we're talking about a new use case for our enterprises, for our customers. We're talking about a use case of being able to have their remote vendors, whether it's accounting, audit teams or IT subcontractors or advisory firms or whoever they want to give access to their Core PAS, and this could be across any of this -- from small all the way up to very large enterprises. And that's something that we believe is going to create incremental revenue to the company.

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

Okay. On that topic. Alero is a new product for you. I think GA-ed it in Q3 or at the end of...

Joshua Siegel - *CyberArk Software Ltd. - CFO*

End of Q3.



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

End of Q3. Right. So it's very early, but I'm sure you had a lot of customer conversations at RSA. Can you talk about what the feedback has been? And then how we should think about how quickly that product could ramp?

Joshua Siegel - CyberArk Software Ltd. - CFO

So the feedback is very positive because it really addresses a true pain point. Today or before Alero, the solution would be that, okay, they would buy a license for our Core PAS, for the PAM product, and then they would -- in order for a remote user to enter into their VPN, which would be -- could take weeks to set up, because they would have to either provide them an RSA or some kind of a chip in order to get into their VPN, set up passwords set up -- provision them essentially to get into their VPN. And today, what Alero allows you to do is enter into the enterprise VPN without a password, without an agent at the enterprise and without the password at the remote user side. So it's very quick and very secure. So this basically solves the problem. And every one of our customers really has remote -- has a requirement for remote access to their CyberArk software.

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

Okay. Where do you think you're going to get budget from for those products? Is it taking spend from VPN?

Joshua Siegel - CyberArk Software Ltd. - CFO

I think because it's really focused on, again, we're doing this not to replace VPN, general VPN into the network of the company. We're doing this so they can access CyberArk in a very clean, efficient VPN-less way without adding any agents to the customer side. So we believe it will be more budget allocated to identity and to Privileged Identity Management at the enterprise level and part of their security budget.

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

Okay. Got it. Let's talk about some of the non-PAM products or the kind of non-core products like Application Identity Manager. You noted that, that product was included in 5 of the top 10 deals this year, but it's still just representing 11% of license revenue. Can you speak to the demand environment? What are the drivers for the Application Identity Manager? And then do you feel like you have to put additional dollars behind it to ramp that product?

Joshua Siegel - CyberArk Software Ltd. - CFO

Yes. So I mean, the drivers behind the Application Access Manager is really around, these are key credentials inside the network that if compromised are a backdoor into basically moving around laterally within the organization. And it's always been there, and we've always had this product for a long time, really around the static applications within the organization. What's happening now would -- when we talked about in the beginning of the session around digital transformation is that now more and more things are being digitized within the IT footprint of an organization. So you have RPA software replacing humans with bots. You have DevOps processes creating new application to application credentials called secrets through the CI/CD tools. And you have now third-party security companies like scanners, the network scanners and the likes, going through networks to analyze what's going on in those networks. So where the application -- or the Application Access Manager fits in is that all of these types of software, whether it's an RPA software or third-party security vendor or setting up DevOps processes, this is basically setting up new credentials that become backdoors that weren't there years ago before kind of looking at the digital transformation. And we see, when we talked about the top 10 deals, many of them having application access management as part of it, it's really -- they're coming to us and saying, okay, let's secure these human credentials, and by the way, we have lots of these very easy, sort of easy applications to fix, like our scanners into the network or RPA, and we can't load those up until we know that it's going to be brokered through CyberArk so that it's secure, just like our human users are secure.

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

So in those cases, are you selling -- do you have to sell to the developer to a certain extent, because developers seem to be or probably are apprehensive to adopt a new tool that potentially could slow down their development process?

Joshua Siegel - CyberArk Software Ltd. - CFO

So on the DevOps processes, the developers are the adopters of it. For that -- for the DevOps piece of the Application Access Manager. And they'll frequently download something through open source and start to just use it and it will proliferate within the R&D organization. And then at some point, the enterprise will say, wait a second, this now has become a security part of our security strategy. Now let's make sure that the vendor who's supplying that open source, we have support and we can get the enterprise version of it, and then they would move into buying it from CyberArk directly, because we have -- they are using the open source. The other approach will be is that if the CSO already is looking at kind of the whole IT infrastructure and is looking at their applications, where they're seeing kind of the RPA and the third-party security vendors and the other static applications going through needing credential management, and then they'll see also R&D is also creating these vulnerabilities. I want one vendor to cover, not just the human users, but also to cover all of these application access user credentials as well. And as we all know, unifying the number of -- or reducing the number of vendors for anything is highly variable within an organization. And that's where we come to play because we can do both the human credential side and the application credential side.

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

Okay, great. Let me just shift to margins. And I have a few questions on that. That was an area that maybe was more controversial coming out of Q4, or perhaps I got the most questions about coming out of Q4. So you ended FY '19 with 26% operating margins, well ahead of your peers. You're guiding to about 22% margins for next year. Can you help investors understand where the incremental spend is going?

Joshua Siegel - CyberArk Software Ltd. - CFO

Yes. Actually, we finished 2019 with a 28% operating margin. It was -- in 2018, we had a 26% operating margin. So we were able actually to -- through our overachievement in 2019, expand those margins by 2 points. So when we think about kind of the 22% operating margin guide that we gave for 2020, of the 6 points, 3 points are really sales and marketing, of which most of it will go towards sales headcount. When we want to grow, not just for this year, we have capacity. But if we want to have capacity as we get to the end of this year and into 2021, then we start to invest in that sales part of the -- in that part of the sales organization already 6 to 9 months in advance of when we want to see that new capacity take effect. We see 2 points coming out in R&D. One point is from FX. The shekel has really strengthened significantly over the last 12 months, which is where most of our development is, in Israel. And then 1 point on really just the incremental investments we're making on the cloud, SaaS offerings that we talked about and really making sure that we're innovative and meeting the new vulnerabilities that are coming out of the digital transformation. We talked about the ones for this year and next year, they're going to be more, and we're trying to stay ahead of the game. And then the last point is really around our cost of goods. As we sell more SaaS products, then that piece will have some impact on our total gross margin. Last year, I think our gross margin was 88%, and so we can see 1% coming off of that this year.

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

Okay. Since a good chunk of it is coming from sales and marketing, can you give us an idea of what you're planning to do in terms of ramping sales capacity next year? And are there any specific geos that are particularly in focus for you?

Joshua Siegel - CyberArk Software Ltd. - CFO

Yes. It's really just adding capacity at the sales front. We -- 70% of our expenses are headcount. And we had a very good year last year in 2019, and people, on average, were overachieving. And so basically, the increased headcount goes to backfilling the overachievement of 2019 and then setting up new capacity for 2021. And it's going to be across the field, it's going to be bag carriers, account executives, it's going to be everyone that supports them from the solution engineers to the inside sales. I think -- we know we hired a new Chief Revenue Officer this year. And he has some strategy around really focusing on customer success and channel development globally. So I think that there will be, as well, as the company scales in revenue, those areas will scale as well.

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

Okay. Well, I have a lot more questions, but let me just see if there's any questions in the audience before I proceed. One right here?

Unidentified Analyst

You've highlighted the headwinds to margins this year. I went back through my notes and it looks like you cover conservatively a year ago or 2. Maybe help us understand what are potential upside drivers to margins this year? Whether it's mix or maybe slower adoption of cloud, et cetera?

Joshua Siegel - CyberArk Software Ltd. - CFO

What would be the -- what would change in the market?

Unidentified Analyst

Yes. What would be the upside drivers? Or you talked about the -- what were the headwinds?

Joshua Siegel - CyberArk Software Ltd. - CFO

Yes. So I think on the upside on the margins are really going to be kind of 2 areas. One is overachievement on revenue, which has happened, which happened last year. If we look back at the guide that we did a year ago in February compared to what we actually achieved, it was, I think, at least 6% or 7% higher. And the second piece would probably be related to hiring cadence. Hiring, as we all know, is one of the biggest challenges of fast-growing companies, especially in the cyber space, where demand is big for that specialty.

So if we don't hire at the same rate, then -- and we can obviously see some upside there on the margins, assuming that we meet our targets on the revenue side. I think on the headwind side, one of the things that we have to start balancing fresh this year more than we have had in the past is our mix of SaaS versus perpetual or our subscription business versus perpetual. And that's one of the things that we called out for the first quarter. That we expect already kind of in Q1, it could be an impact of \$3 million of revenue because we're doing more ratable business in Q1. And that would translate, could translate to \$10 million to \$15 million over the full year as well.

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

Are you making any changes from a sales force incentive perspective to push those subscriptions or SaaS products over the license?

Joshua Siegel - CyberArk Software Ltd. - CFO

Yes. And before I answer that, I also, just to clarify, anything that -- when I talked about the full year, that's already incorporated, obviously, into the guidance that we gave. But yes, we actually did change the comp plan this year to really focus on making sure that the account executives are

encouraged to sell SaaS when it's right for the company to sell SaaS. And so it really plays out for our Endpoint Privilege Manager, which can be either sold as SaaS or perpetual. So we want to make sure that just because the perpetual contract might be a larger dollar amount that the account executive is still encouraged to sell the SaaS contract because we think that, that would be more appropriate for the customer. And then, of course, when they're looking at the privilege cloud, similarly, that they -- where we think it's appropriate for them to sell Privileged Cloud, they're encouraged to sell it there. So we've put tweaks and incentives into the compensation plan so that, hopefully, it matches what our strategy is for the year.

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

Okay. Since you noted that one of the areas that could drive margin improvement is overachievement in revenue. Could you talk about what your expectation is in terms of the demand environment for your solutions in 2020? As we're looking out into the year, is there any kind of -- do you think there will be any change in the overall demand relative to what you saw coming into 2019?

Joshua Siegel - CyberArk Software Ltd. - CFO

Yes, I think from the pure market reasons, I mean, obviously, macro and force majeure issues that we all seem to be thinking about today, but thinking about where Privileged Access Management is, where cybersecurity is and where we are in the opportunity there, then we feel like it's kind of -- it's very similar to how we looked at it going into 2019. There's been no change in terms of the sets of priorities of where CSOs are focusing on setting up their -- on how they set up their cybersecurity strategy within their organization. There's been only more regulations, such as CCPA, out in California, which has followed through to GDPR and there are others in the works that are really going to just even make more sense for why you need to manage that privileged access and access to the key data and the personal identifiable information, and also put enterprises more on alert and more risk of if they're not complying with those regulations.

So I think the pure, practical cyber breach risk of attackers going out after this information, personal identifiable information, after money, after the reward from the attacker side and also from the regulation side, combined we see the opportunity as ripe as it's been.

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

Okay. That's great. Well, I think we'll leave it there since we're all out of time. But thank you, Josh, for coming.

Joshua Siegel - CyberArk Software Ltd. - CFO

Thank you, Melissa.

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

You've been great. And thank you, everyone, for coming.

Joshua Siegel - CyberArk Software Ltd. - CFO

Great. Thank you.



DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2020, Thomson Reuters. All Rights Reserved.