

Sophos Group plc FY19 Results

16 May 2019

SOPHOS

Safe Harbour

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Business Update

Kris Hagerman, CEO

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FY19 Summary

- Challenging year, primarily due to difficult compare
- Strong growth in revenue (12% CC), and step change improvement in profitability
 - Subscription revenue of 17% (CC) the key driver
- Billings broadly flat YOY
 - Renewal rate of 124%, facing headwind of 140% in FY18, driven by high levels of cross-sell in prior year
 - Mix shift impact, with strong growth in smaller customers, particularly driven by managed service provider (MSP) monthly billings and a modest reduction in the number of larger transactions
 - Weaker Network hardware billings as customers extended refresh cycles
 - Total subscription renewal base now exceeds \$1.2B, growing 14% (19% at CC)
 - Added 35,000 net new term customers, for total customer base of over 335,000; now in excess of 382,000 including MSP customers
 - Strong growth in MSP of 119%
- Continued strong demand for next-generation (“next-gen”) solutions
 - Next-gen⁽¹⁾ product portfolio, including Sophos Central and XG Firewall, grew 30% YOY (CC) to \$340M, and now represents 47% of billings
 - Within next-gen portfolio, Sophos Central grew 23% YOY to \$228M, off a strong compare
- Continued investment in innovation
 - Sophos Central enhancements in scalability, performance, enterprise features, and MSP
 - Intercept X Advanced with EDR; leading EDR that does not require a large team of security experts
 - XG Firewall v17.5; synchronized security, dynamic application control, and Sophos Central management
 - Acquisitions of Avid Secure (public cloud security) and DarkBytes (MDR)
- Outlook: We believe the drivers are in place for continued future revenue growth, principally driven by growth in our subscription business, especially in our next-generation products. We intend to continue to invest to support this growth, with a return to operating profit margin leverage after FY20

Financial Performance Overview

Strong revenue and adjusted operating profit growth

+12%

Constant Currency Revenue ⁽²⁾

Total revenue +11% at reported rates.
Subscription revenue growth of 17% (CC) and
16% at actual rates

\$109.0M

Adjusted Operating Profit ⁽³⁾

vs. \$58.3M FY18⁽²⁾
Improvement resulting from recognition to
revenue of prior-period subscription billings

\$143.0M

Net Cash Flow from Operations

vs. \$147.7M FY18⁽²⁾
Broadly similar YOY as improvement in
working capital offset by lower uFCF

\$760.3M

Billings ⁽⁴⁾

vs. \$768.6M FY18
Flat YOY at constant currency given difficult
compare, though healthy renewal rate
of 124%

\$168.0M

Cash EBITDA ⁽⁵⁾

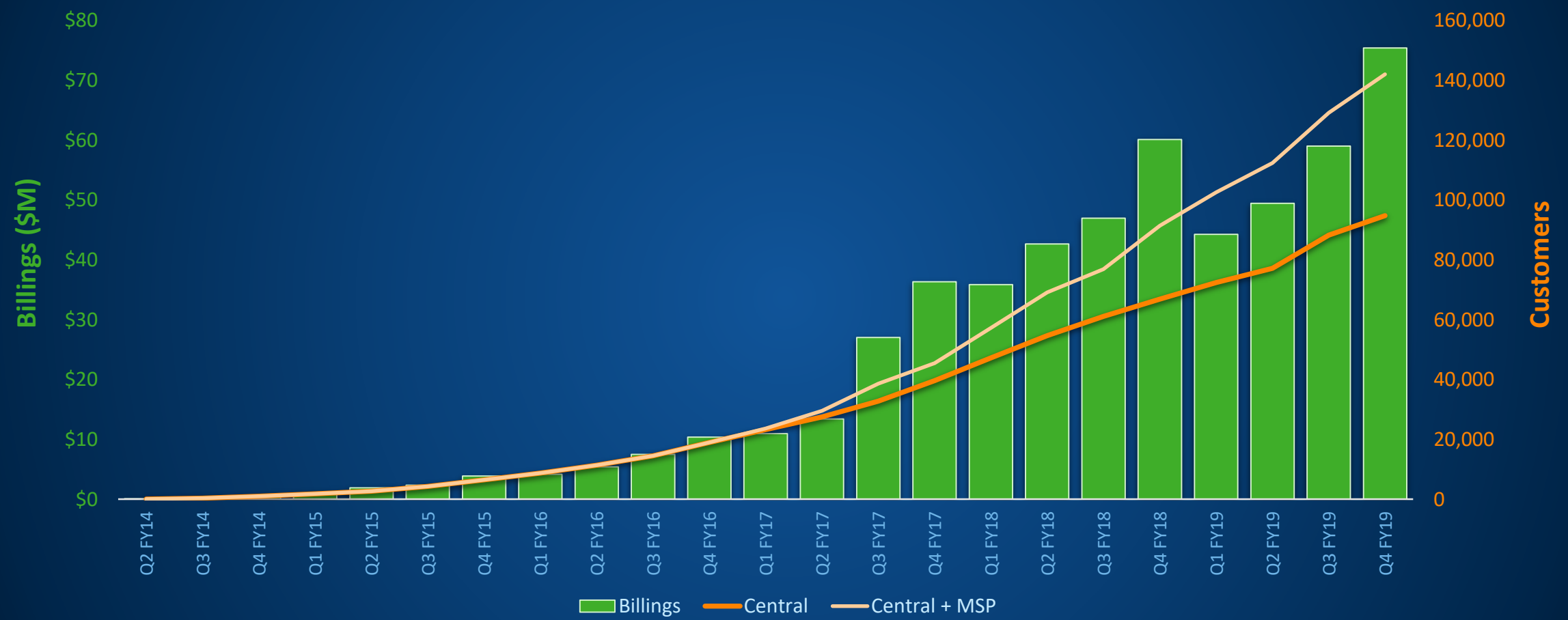
vs. \$199.2M FY18⁽²⁾
Reduction reflecting continued
investment in the business for growth

\$123.8M

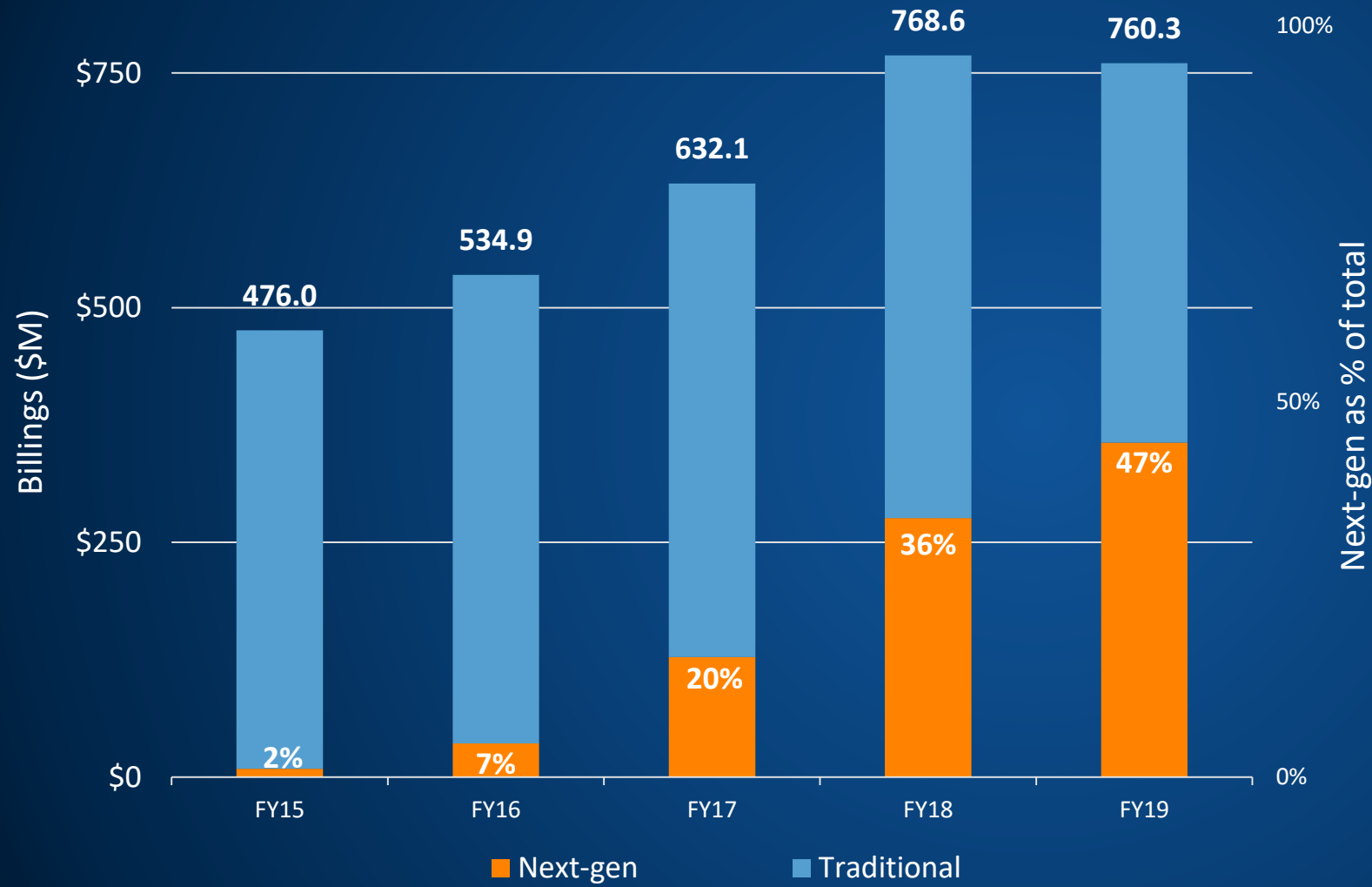
Unlevered Free Cash Flow ⁽⁶⁾

vs. \$139.6M FY17
Lower YOY due to continued investment to
support future growth

Continued Sophos Central Momentum

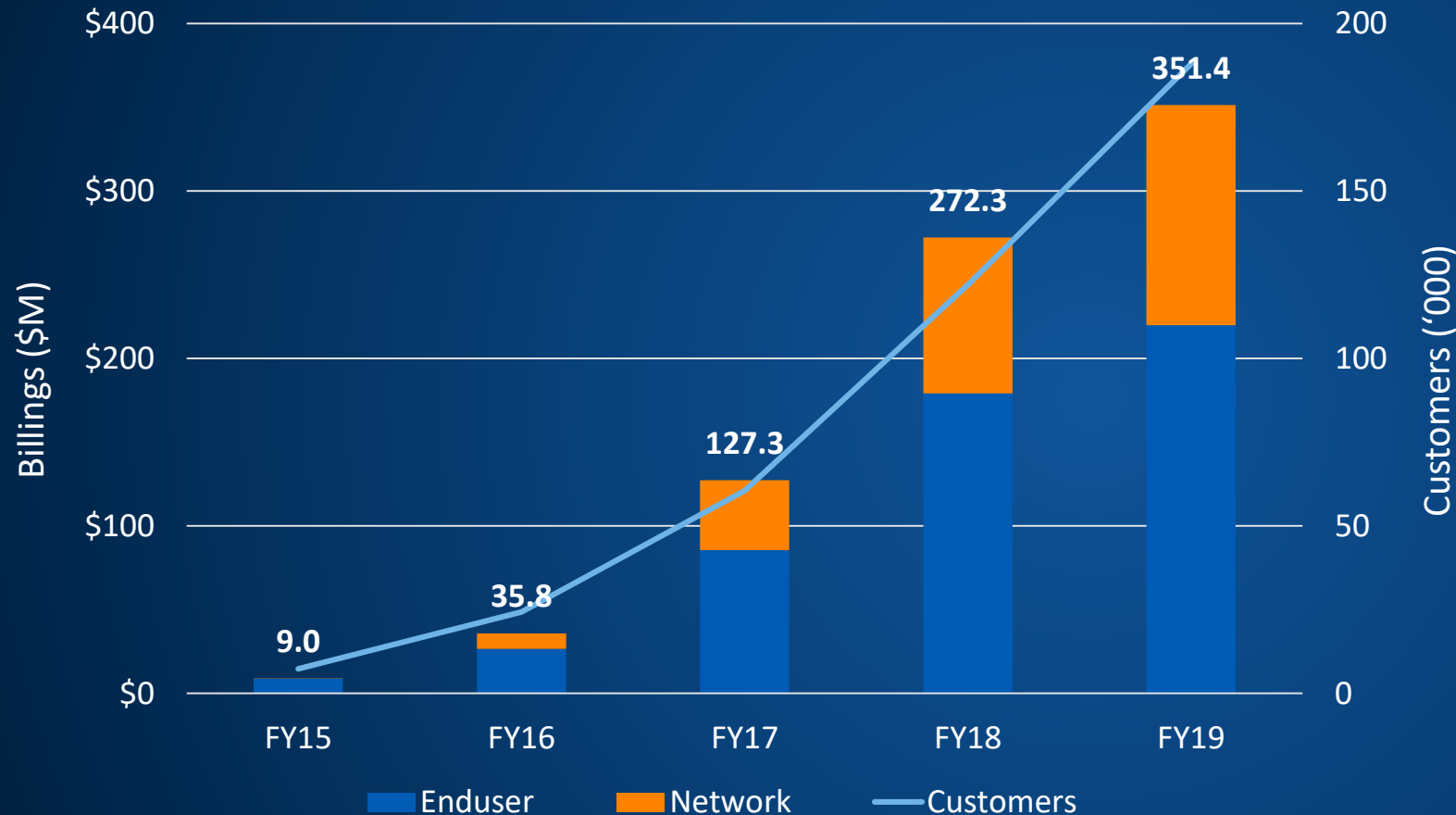


Next-Gen Transition



- Next-gen is a major market opportunity and represents the future of Sophos
- 30% growth in FY19
- Rapidly increasing as share of Sophos business
- Now represents 47% of total billings

Next-Gen Portfolio Momentum



- In scale, growth, and product innovation, Sophos is a market leader in next-gen cybersecurity
- Especially strong performance in new customers
- Net increase in next-gen customers in Q4 FY19 of over 11,000 (incl. MSP)
- c.90% of new customer business in endpoint is next-gen, and c.60% in UTM/firewall

Consistent Growth in Number of Customers



- Over 35,000 net new customers in FY19 (excl. MSP)
- Total customer base excluding MSP of over 335,000 (including MSP over 382,000)

Cybersecurity Evolved



**SYNCHRONIZED
SECURITY EVOLVED**



**"ALL IN"
ON AI**



**APIs
EVERYWHERE**



**OPTIMIZED FOR
THE PUBLIC CLOUD**



**BUILT FOR ZERO
TRUST**



**EVERYTHING AS A
SERVICE**

- Project Darwin – taking synchronized security to the next level
- One of the most powerful AI capabilities in the market
- Open Sophos Central up via APIs – to customers, partners, other vendors
- Offerings now span across endpoint, network, and public cloud
- Architected for Zero Trust
- Over time, everything we offer will move to “as a service”

SOPHOS
Intercept 

SOPHOS
XG Firewall

SOPHOS
Cloud Optix 



Encryption



Mobile



Server



Wireless



Phish Threat



Mail

Sophos  Central

SOPHOS  labs

APIs

ADMIN

PARTNER

VENDOR

Financial Results

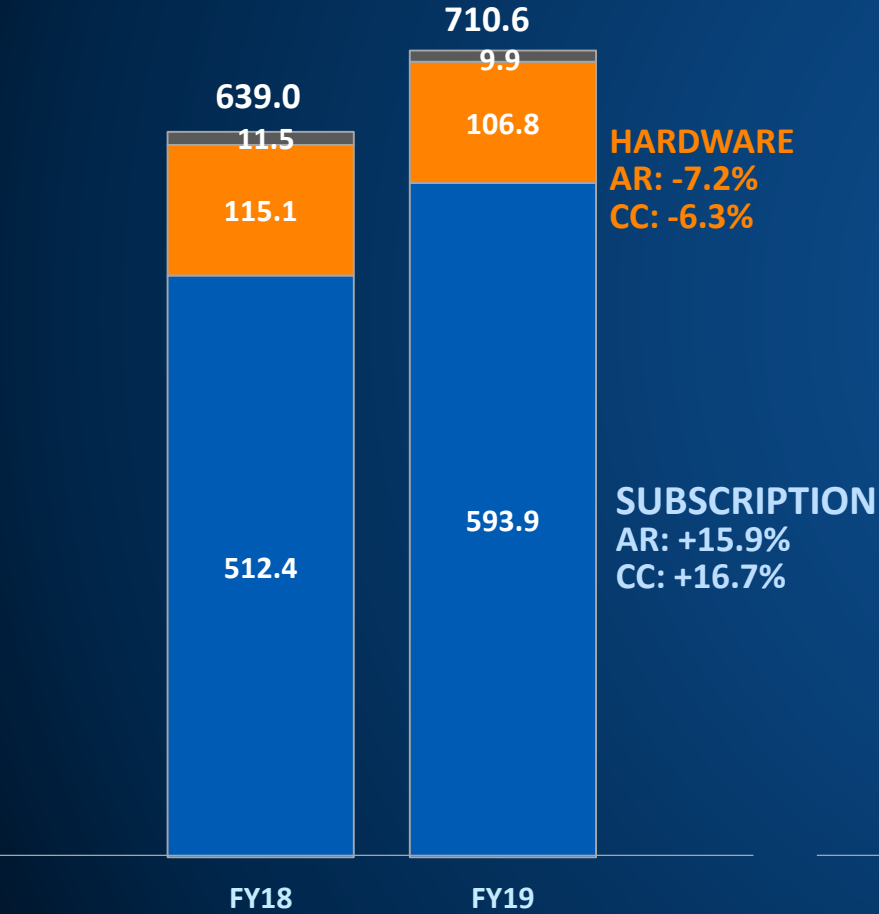
Nick Bray, CFO

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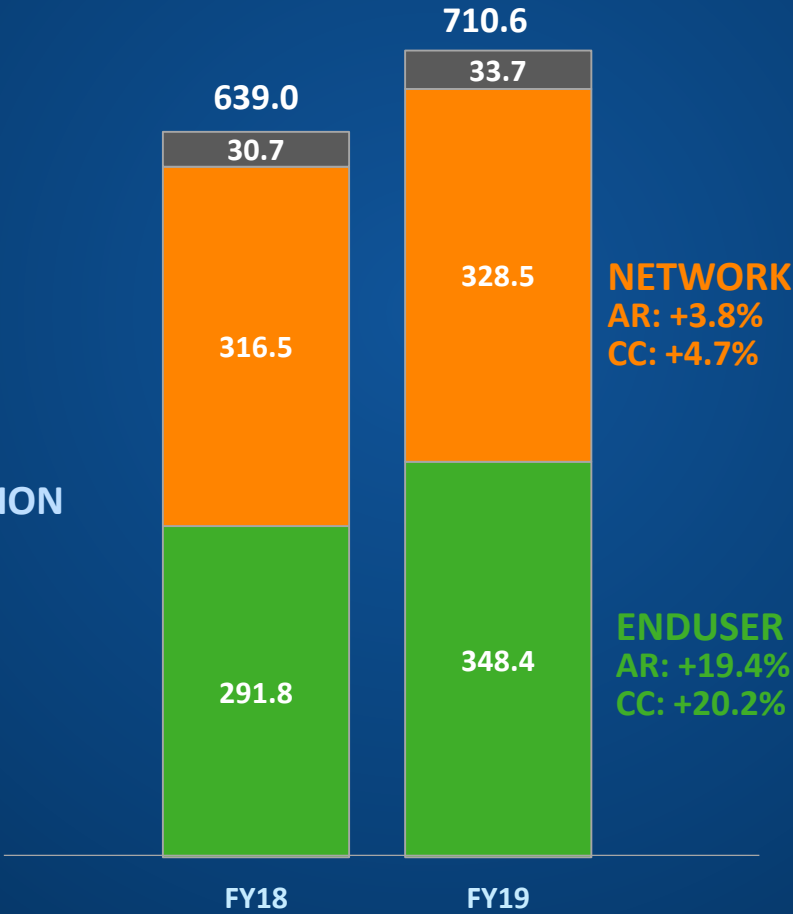
Revenue Performance

Revenue⁽²⁾ growth of 11.2%, or 12.0% at constant currency

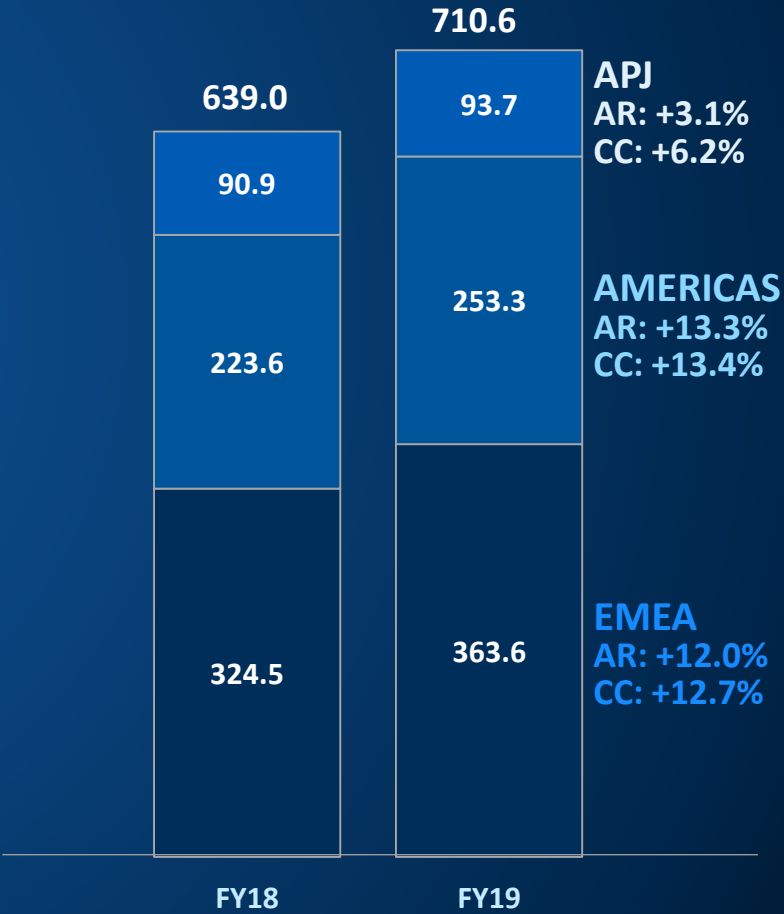
REPORTED REVENUE BY TYPE (\$M)



REPORTED REVENUE BY PRODUCT (\$M)



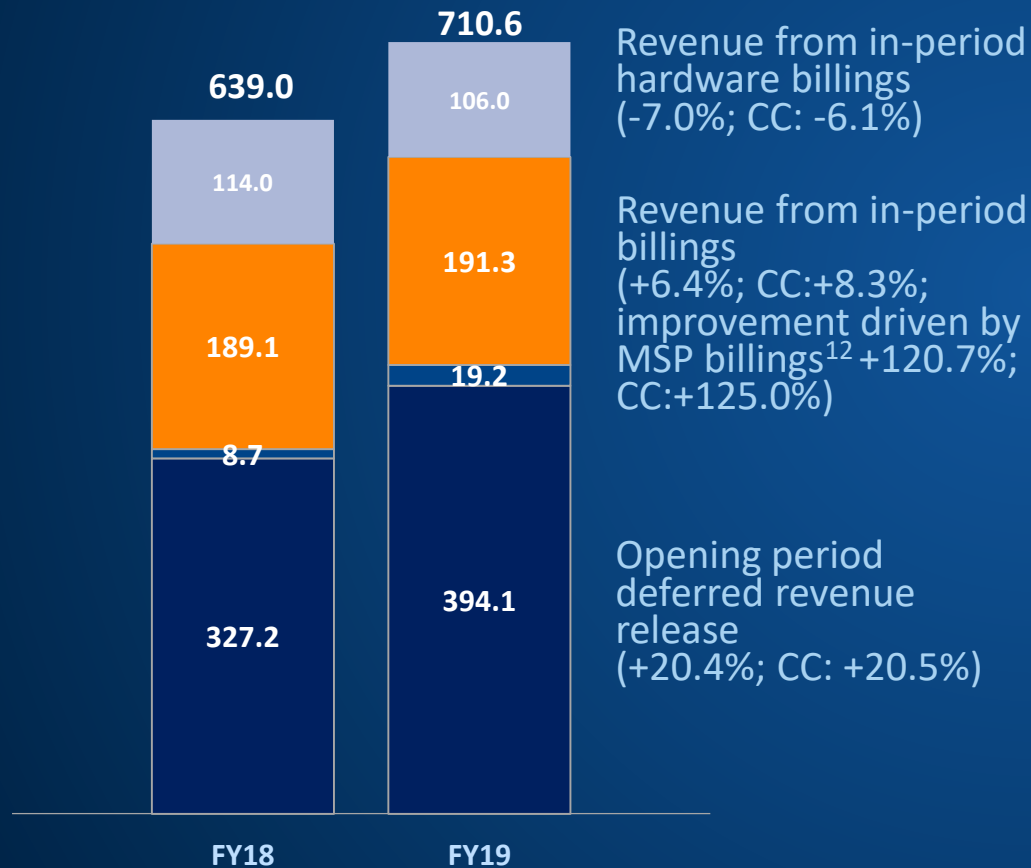
REPORTED REVENUE BY REGION (\$M)



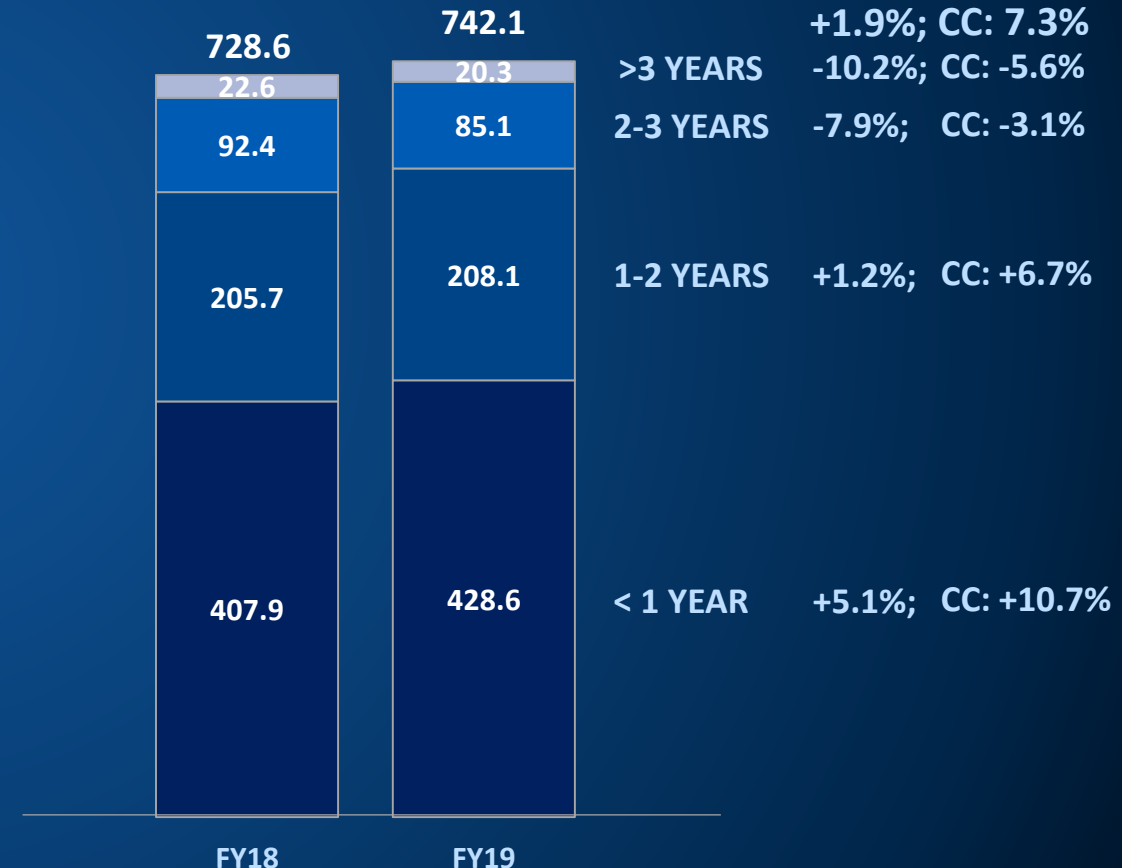
Revenue by Year of Recognition

Deferred revenue⁽²⁾ growth driven by subscription billings growth partially offset by FX

REPORTED REVENUE BY SOURCE (\$M)



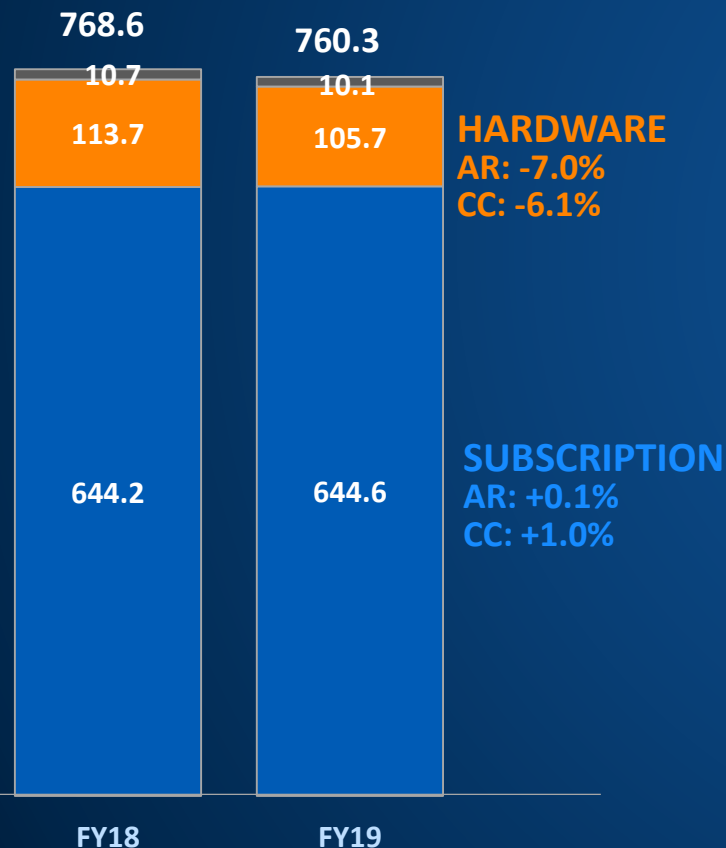
DEFERRED REVENUE (\$M)



Billings Performance

Subscription billings⁽⁴⁾ growth of 1.0% at constant currency, or 0.1% at actual rates

REPORTED BILLINGS BY TYPE (\$M)



BILLINGS DRIVERS

- Brand new customer billings⁽⁷⁾ up 2% at constant currency
 - Mix shift with fewer larger transactions and accelerating MSP business (smaller customers, monthly billings)
- Existing customers renewal rates⁽⁸⁾ at 124%
- High visibility of the renewal book
 - Next 12 months renewals base +14% (+19% CC)
 - Greater than 12 months renewals base +9% (+14% CC)
 - Total renewals base⁽⁹⁾ now \$1.2B, +11% YOY (+16% CC)

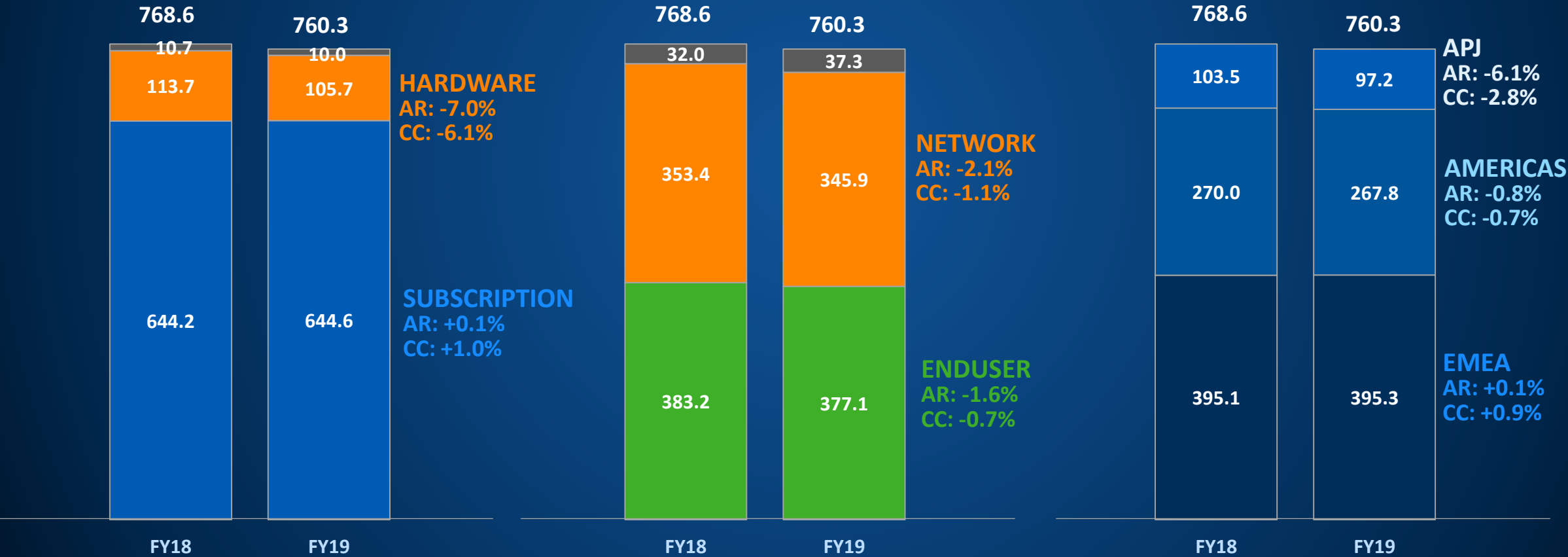
Billings Performance

Subscription billings growth of 1.0% at constant currency, or 0.1% at actual rates

REPORTED BILLINGS BY TYPE (\$M)

REPORTED BILLINGS BY PRODUCT (\$M)

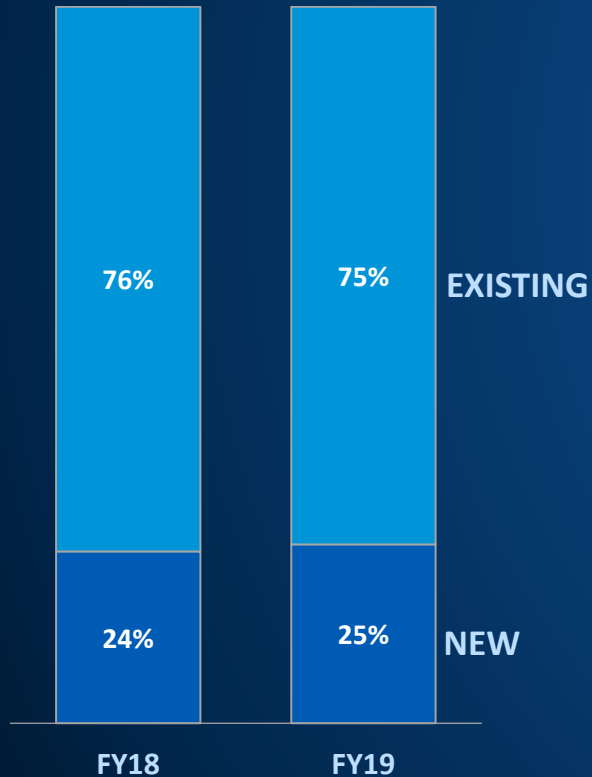
REPORTED BILLINGS BY REGION (\$M)



Key Billings Metrics

Starting to see effects of MSP in the mix

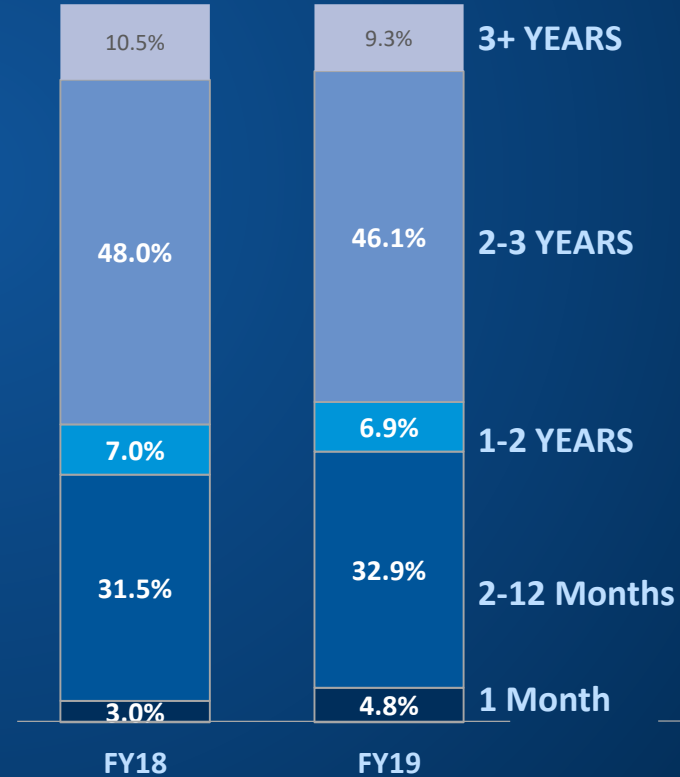
BILLINGS BY CUSTOMER TYPE⁽⁶⁾



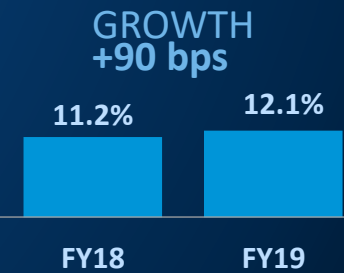
BILLINGS BY SIZE (Employees)



BILLINGS BY LENGTH OF CONTRACT⁽¹⁰⁾



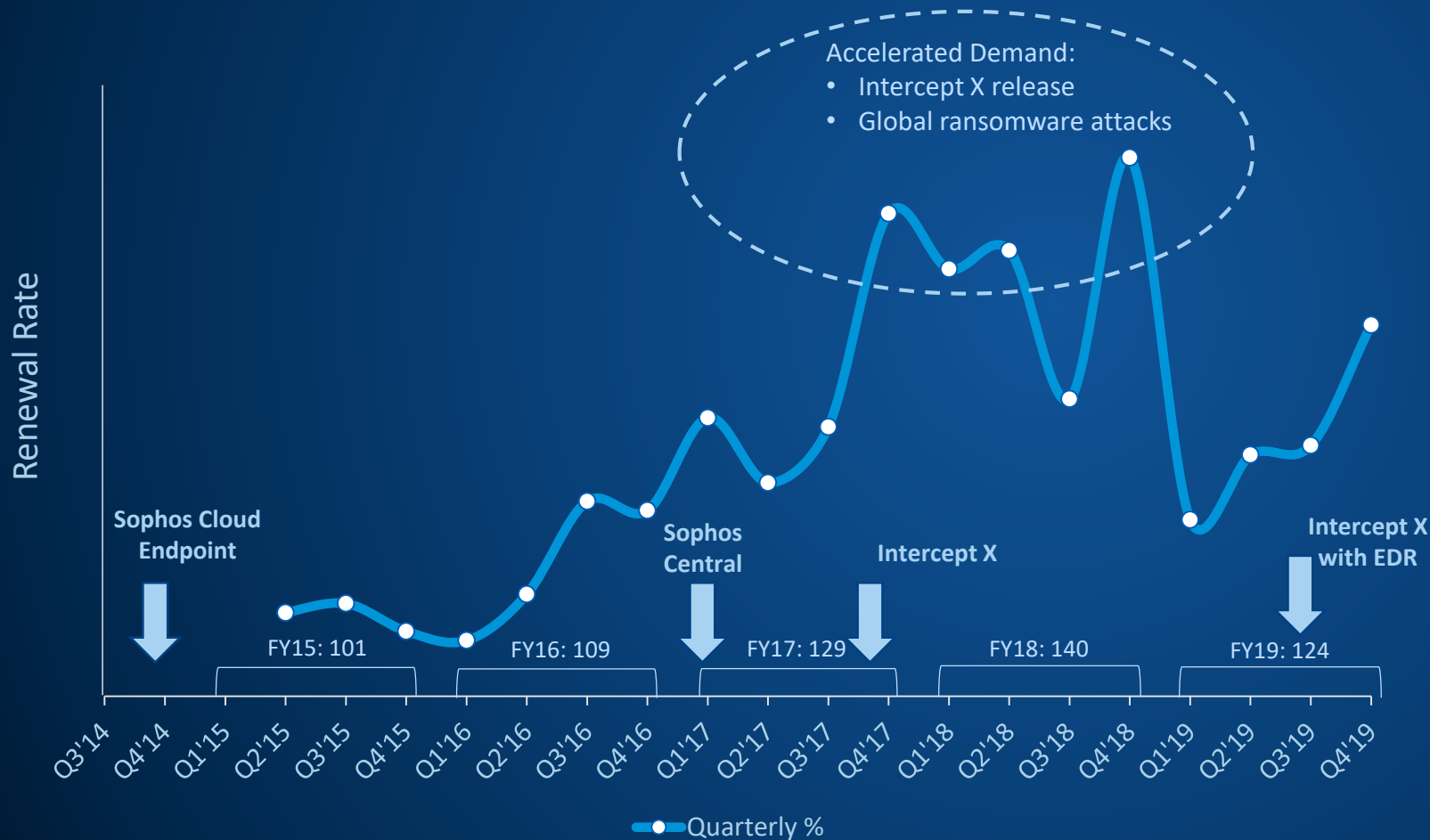
PERCENTAGE OF CUSTOMERS WITH UTM AND ENDPOINT



- Weighted average contract length⁽¹⁰⁾ of 26.4 months, a small decrease on 27.6 months mainly due to mix change toward MSP

5-Year Renewal Rate and FY20 Considerations

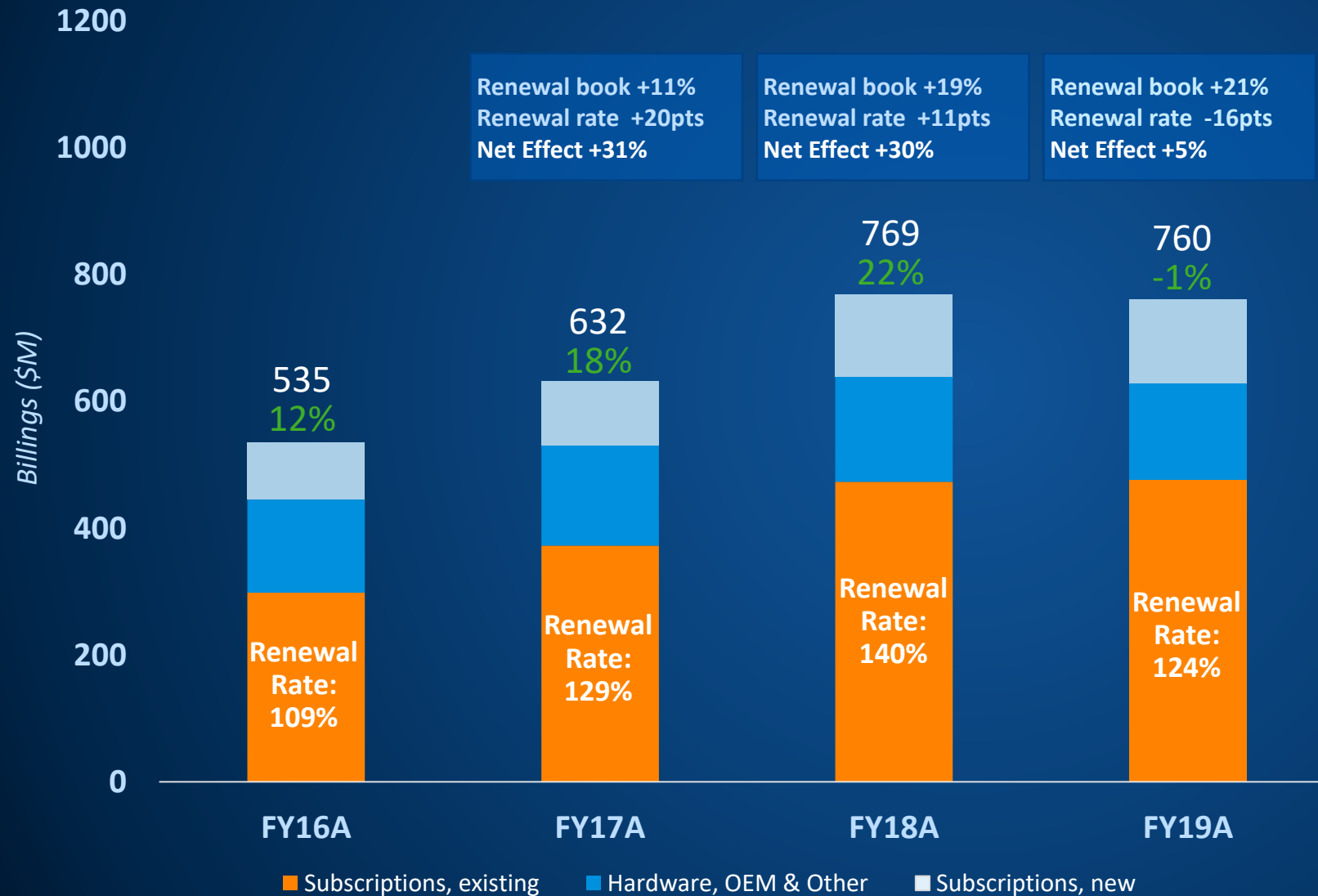
Period of unusually high demand and cross-sell in prior-year



FY20 Considerations

- Renewal rate variability linked to numerous factors including market, product release cycle, and transition to next-gen products
- Solid close to the year yet reasons to remain cautious on FY20 renewal rate until proven otherwise
- Strong product pipeline of additional next-gen products (Cloud Optix, EDR v2.0, XG Firewall v18.0, MDR, etc.)

Renewal Rate, Renewal Book, and FY20 Considerations



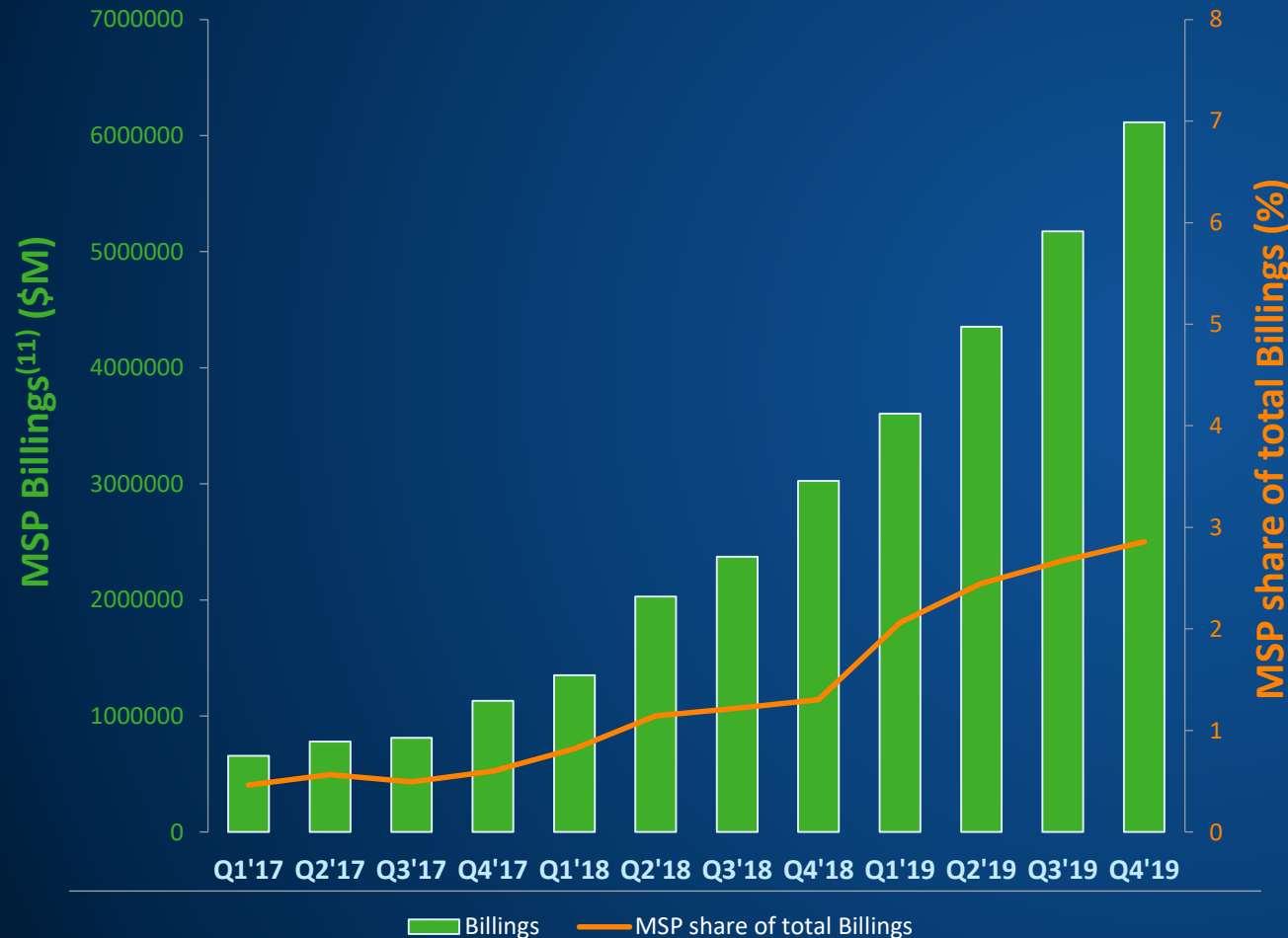
FY19

- Good growth in the annual renewal book, +21% to \$381 million
- Moderating renewal rate counteracted this growth

FY20 Considerations

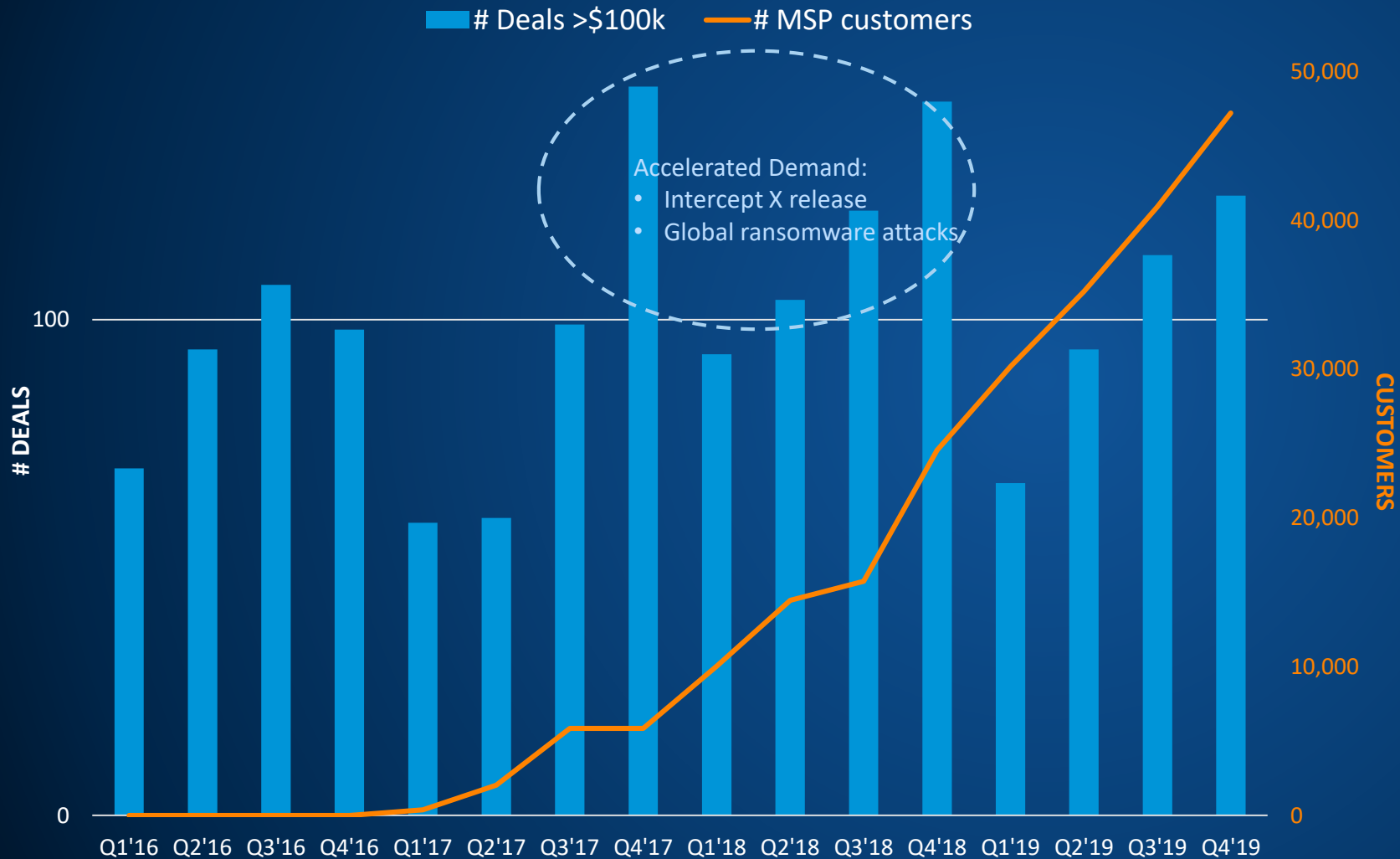
- Another year with good growth in the renewal book, with FY20 increasing by 14% (c.\$55 million) (19.5% at constant currency)

Managed Service Provider (“MSP”) Channel



- Sophos Central and synchronized Security represent compelling offering for MSP partners
- Significant growth opportunity
- Particularly attractive model for smaller customers
- MSP business is billed monthly and recognized to revenue immediately
- MSP billings⁽¹¹⁾ in Q4'19 equate to \$27 million in ARR

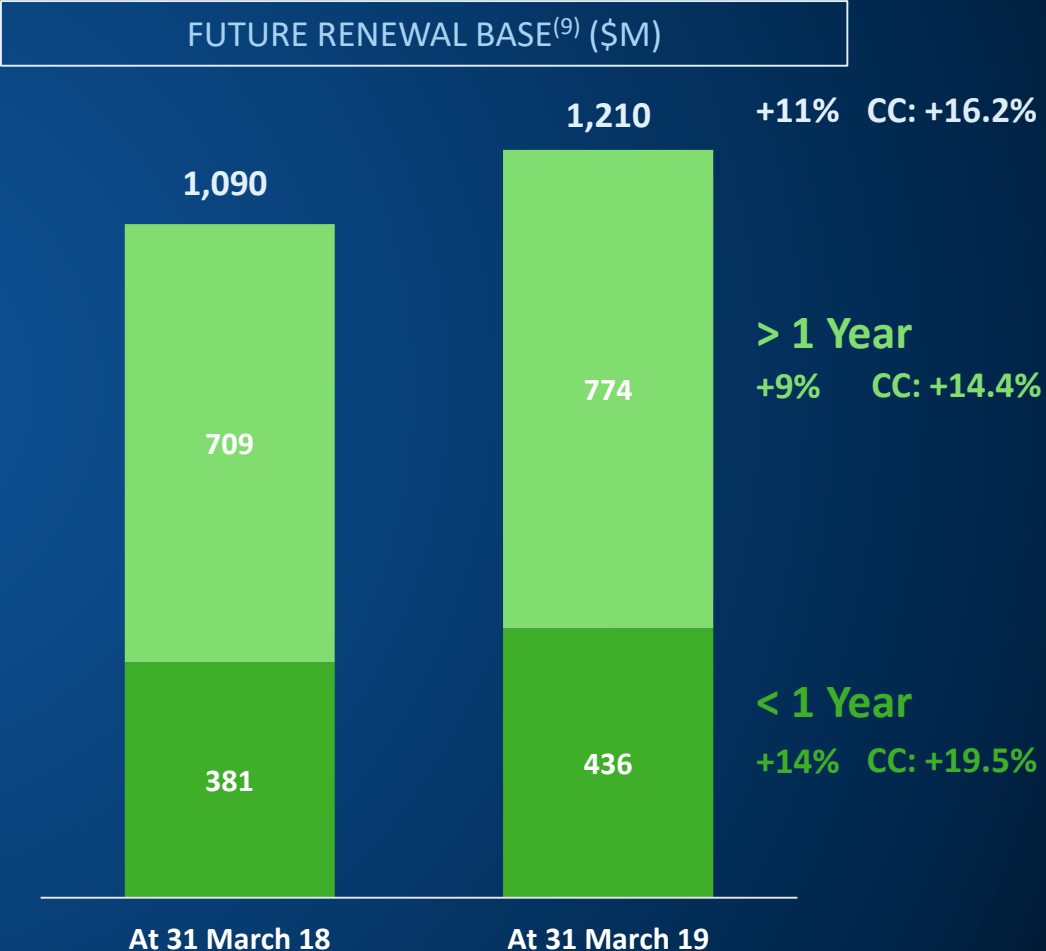
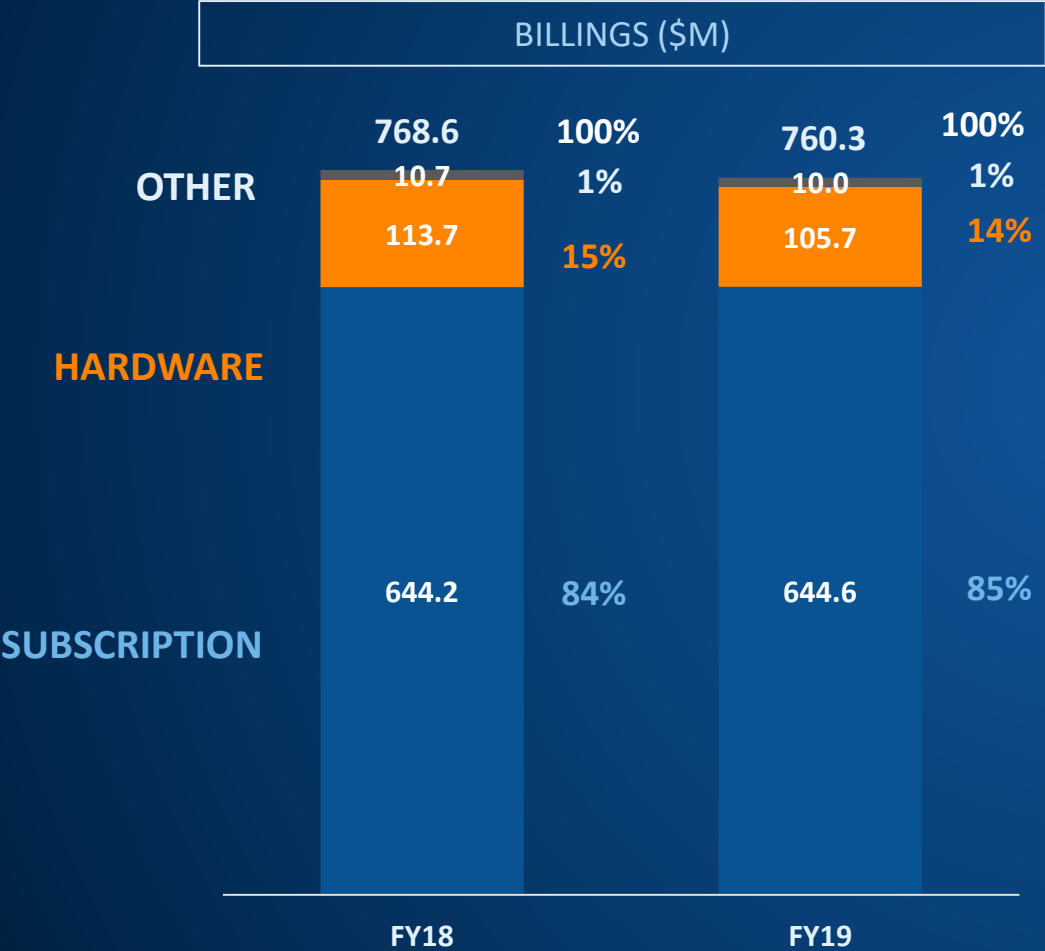
Shift in Business Mix



- FY18 increase in # of larger deals
 - This has now returned to normal levels
- Ongoing increase in # of MSP customers
 - Typically monthly billings, straight to revenue
 - Modest reduction to overall average contract duration
- MSP is solid attractive new business but suppresses headline billings growth

Renewal Base Visibility and Sustainability

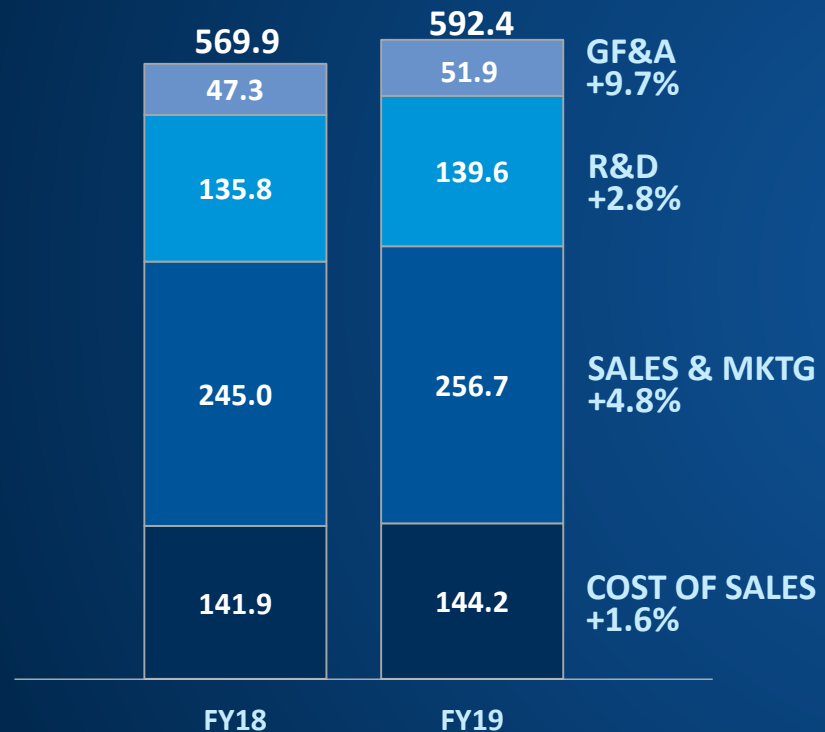
Renewal base exceeds \$1.2 Billion



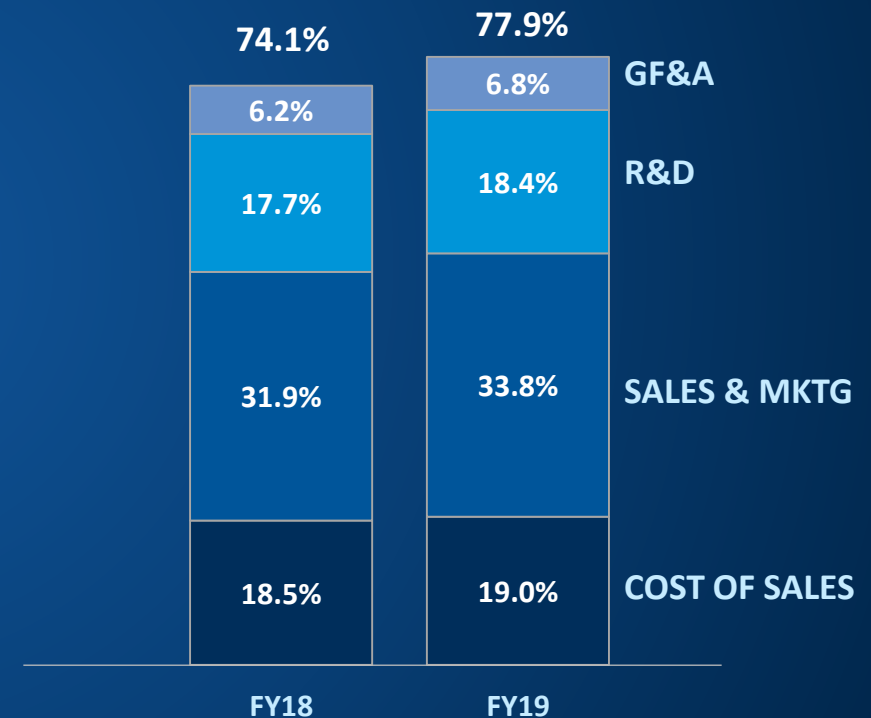
Expense Performance

Continuing to invest for growth opportunity

COST ANALYSIS (\$M)⁽²⁾⁽¹²⁾



COSTS AS % OF BILLINGS^{(2) (12)}



Cash EBITDA and Statutory Income Statement

87.0% increase in adjusted operating profit

CASH EBITDA⁽²⁾ RECONCILIATION

\$M	FY18	FY19
Cash EBITDA	199.2	167.9
Net deferral of revenue and selling costs	(121.2)	(48.8)
Depreciation	(11.6)	(11.6)
Unrealised foreign exchange loss	(8.1)	1.5
Adjusted operating profit	58.3	109.0

STATUTORY INCOME STATEMENT ⁽²⁾

\$M	FY18	FY19
Billings	768.6	760.3
Net deferral of revenue	(129.6)	(49.7)
Revenue	639.0	710.6
Cost of sales	(144.0)	(146.4)
Gross profit	495.0	564.2
Sales and marketing	(239.9)	(259.9)
Research and development	(140.3)	(143.9)
General finance and administration	(49.6)	(52.9)
FX profit/loss	(6.9)	1.5
Adjusted operating profit	58.3	109.0
Amortisation	(25.2)	(16.9)
Share based payment expense	(39.6)	(35.0)
Exceptional items	(13.2)	3.8
Operating result	(19.7)	60.9
Net interest expense	(21.3)	(7.3)
Result before tax	(41.0)	53.6
Tax	(19.9)	(26.7)
Result for the period	(60.9)	26.9

Cash Flow

Cash from operations largely maintained, reflecting continued focus on cash management

ADJUSTED OPERATING PROFIT⁽²⁾ TO UFCF RECONCILIATION

\$M	FY18	FY19
Adjusted operating profit	58.3	109.0
Net deferral of revenue and costs	121.2	48.8
Exceptional items*	(13.0)	(3.1)
Depreciation	11.6	11.6
Unrealised foreign exchange	8.1	(1.5)
Change in working capital	(12.2)	(5.2)
Cash tax	(26.3)	(16.7)
Net cash from operating activities	147.7	142.9
Exceptional items*	13.0	3.1
Capex	(21.1)	(22.2)
Unlevered FCF	139.6	123.8

*Excludes non-cash fair-value adjustment on contingent consideration

- **Working capital**

Continued strong focus on working capital, expected to grow with the business

- **Capex**

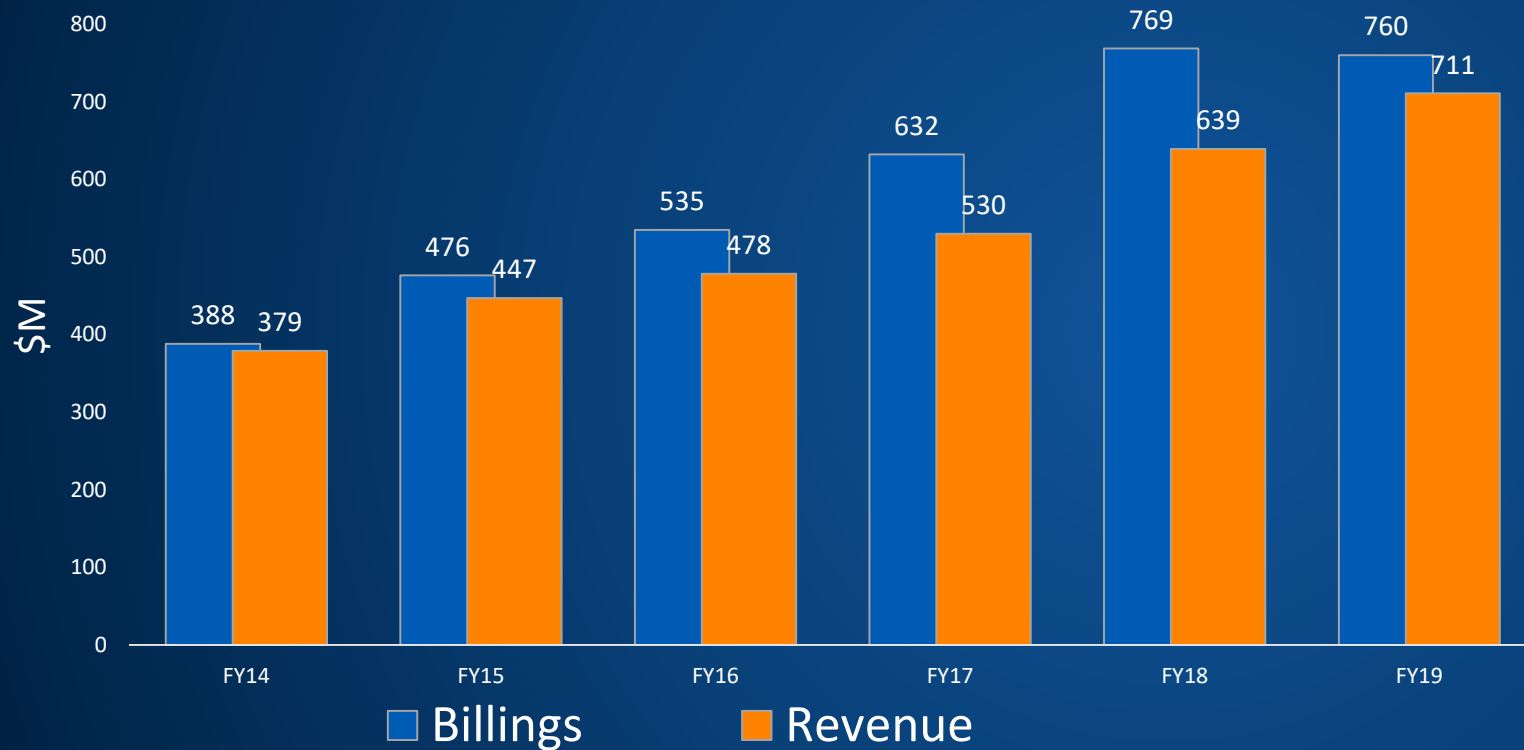
Expected to remain at consistent levels as investment in business continues

- **Cash-tax**

Expected to increase modestly in future years with improving profitability; potential for one-time increase with resolution of overseas tax matters

Revenue and Billings Performance

Five year Revenue CAGR of 13% and Billings CAGR of 14%



Key Drivers

- Deferred Revenue
- Renewals: Base / Rate
- New business
- Subscription: Term / MSP mix
- Hardware

Outlook



Summary and Outlook

Kris Hagerman, CEO

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Summary and Outlook

- FY19
 - Challenging year, primarily due to difficult compare
 - Strong growth in revenue, especially subscription revenue, and adjusted operating profit
 - Flat billings YOY; reduced visibility into billings driven by variations in the renewal rate
 - Billings less indicative of medium-term growth, as MSP revenues expand and as more of our products are delivered as a service
 - Accordingly, our guidance is now focused on revenue and adjusted operating profit
- Looking ahead
 - Demand for cybersecurity remains robust
 - We are well-positioned competitively, especially as more organizations adopt next-gen cybersecurity offerings
 - An exciting transition underway; our next-gen offerings are rapidly increasing as a share of our total business
 - In scale, growth, and product innovation – Sophos has become a leader in next-gen cybersecurity
- Outlook
 - Drivers are in place for continued future revenue growth, principally driven by growth in our subscription business, especially in our next-generation products
 - We intend to continue to invest to support this growth, with a return to operating profit margin leverage after FY20

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Cybersecurity evolved.

Q&A

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Impact of IFRS 15

Limited impact on revenue; main impact on commission costs deferral

IMPACT (\$M)

\$M	Six-months ended 30 September 2017			Year-ended 31 March 2018		
	As previously reported	IFRS 15	Restated	As previously reported	IFRS 15	Restated
Revenue	298.1	(1.3)	296.8	640.7	(1.7)	639.0
Cost of sales	(65.8)	(0.4)	(66.2)	(143.3)	(0.7)	(144.0)
Sales and marketing expense	(119.9)	2.3	(117.6)	(249.0)	9.1	(239.9)
Operating loss	(23.8)	0.6	(23.2)	(31.9)	6.7	(25.2)
Income tax	(2.7)	(0.1)	(2.8)	(14.0)	(1.3)	(15.3)
Loss for the period	(38.8)	0.5	(38.3)	(66.3)	5.4	(60.9)
Trade and other receivables	122.4	38.2	160.6	177.8	44.7	222.5
Deferred tax (net)	129.7	(12.2)	117.5	119.8	(13.6)	106.2
Deferred revenue	(654.4)	27.1	(627.3)	(755.7)	27.1	(728.6)
Net assets	117.9	53.1	171.0	91.8	58.2	150.0

KEY CHANGES

- Earlier recognition of revenue on certain products
- Deferral of commissions and other incremental costs incurred to obtain a contract with a customer

Impact of IFRS 16

Improvement in Non-GAAP measures but key Statutory measures unaffected

KEY CHANGES

- The Group applied IFRS 16 initially on 1 April 2019 using the modified retrospective approach, with no restatement of comparative information
- Operating lease expenditure will be replaced by depreciation of the right of use (“ROU”) asset together with a finance expense
- Alternative performance measures which exclude depreciation, will benefit from the adoption of IFRS 16 through the removal of the operating lease charge
- The “Net cash flow from operating activities” will improve due to the depreciation adjustment, with a corresponding increase in “Net cash flow from financing activities”
- Based on the information currently available, the Group estimates that additional lease liabilities of \$69M will be recognised together with ROU assets comprising offices and plant and equipment of \$61M

End Notes

- (1) The next-gen product portfolio consists of the Group's most advanced products, managed in Sophos Central, notably including Sophos Intercept X for endpoint protection and the Sophos XG Firewall.
- (2) Restated for the adoption of IFRS 15 and change in accounting policy in respect of research and development expenditure tax credit scheme and provision for interest on uncertain tax positions
- (3) Adjusted operating profit represents the Group's operating profit/(loss) adjusted for amortisation charges, share option charges and exceptional items
- (4) Billings represents the value of products and services invoiced to customers after receiving a purchase order from the customer and delivering products and services to them, or for which there is no right to a refund. Billings does not equate to statutory revenue.
- (5) Cash earnings before interest, taxation, depreciation and amortisation ("Cash EBITDA") is defined as the Group's operating (loss) / profit adjusted for depreciation and amortisation charges, any gain or loss on the sale of tangible and intangible assets, share option charges, unrealised foreign exchange differences and exceptional items, with billings replacing recognised revenue.
- (6) Unlevered Free Cash Flow represents Cash EBITDA less purchases of property, plant and equipment and intangibles, plus cash flows in relation to changes in working capital and taxation.
- (7) Constant currency billings excluding OEM.
- (8) Renewal rate calculated as value of contracts renewed in a period / contracts up for renewal in the period. Calculation is at constant currency and includes upsell and cross-sell.
- (9) Renewal base excludes acquisitions and OEM and is at reported exchange rates.
- (10) Constant currency billings.
- (11) MSP Billings exclude Reflexion.
- (12) Expenses included within the definition of cash EBITDA at actual exchange rates.

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