

# Sophos Group plc FY20 H1 Results

6 November 2019

**SOPHOS**

# Safe Harbour

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# Business Update

Kris Hagerman, CEO

*Note:*

*Sophos is currently in an offer period and the discussion today will be limited to the financial results for the period under review*

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# H1 FY20 Summary

- Revenue and billings<sup>(1)</sup> grew by 8% and 9% respectively at constant currency (“CC”)
  - Next-gen<sup>(2)</sup> transition continues, now over 56% of total billings
  - Subscription business remains strong
  - Strong growth in Sophos Central, underpins next-gen and cross-sell
  - Growth in Enduser, Network, New Business, and MSP<sup>(3)</sup>
- Pre-tax loss after exceptional items of \$2 million (PBT \$26 million in H1 FY19)
  - Adjusted operating profit<sup>(4)</sup> flat YOY at \$49 million, after further investment
- Technology and Innovation
  - Launched Sophos MTR, leveraging best-in-class protection of Intercept X Advanced EDR endpoint
  - EAP (Early Access Program) now open for XG Firewall v18, available to all partners and customers
- We continue to execute on an effective and differentiated strategy

# H1 FY20 Financial Performance Overview

*Billings and revenue growth, with profit and cash flow aided by IFRS 16*

**7.9%**

## Constant Currency Revenue

+4.7% at actual rates

Subscription revenue +11.1% (CC)

Hardware -4.6% (CC)

**\$49.4M**

## Adjusted Operating Profit<sup>(4)</sup>

vs. \$49.9M H1 FY19

Flat YOY with revenue growth  
and further investment

**\$93.8M**

## Net Cash Flow from Operations

vs. \$81.5M H1 FY19

Absence of FY19 VPP payment  
Profitability improvement  
IFRS 16 benefit

**\$372.0M**

## Billings<sup>(1)</sup>

vs. \$352.7M H1 FY19

Up 8.7% YOY (CC)

Modest YOY lift in net renewal rate  
New business +6% (CC) driven by MSP

**\$66.8M**

## Cash EBITDA<sup>(5)</sup>

vs. \$54.0M H1 FY19

Billings growth with a benefit from IFRS 16  
partially offset by further investment

**\$90.4M**

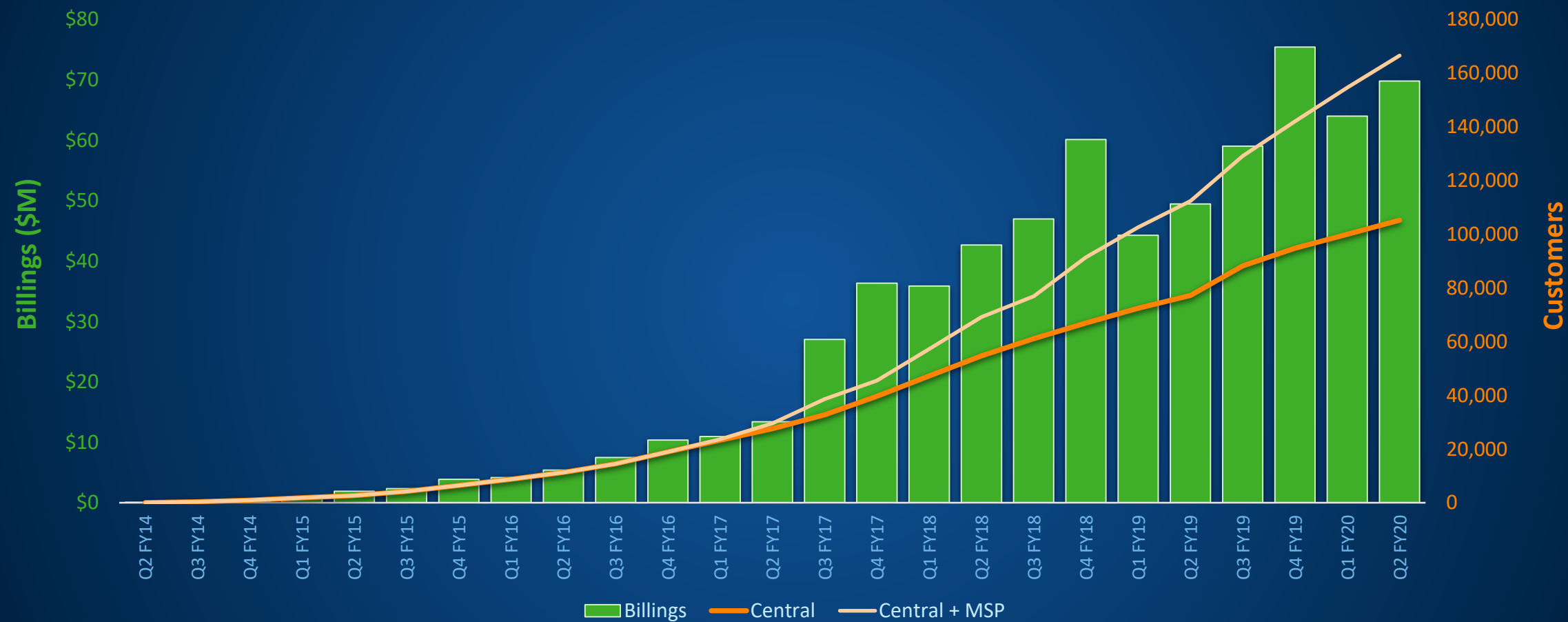
## Unlevered Free Cash Flow<sup>(6)</sup>

vs. \$71.6M H1 FY19

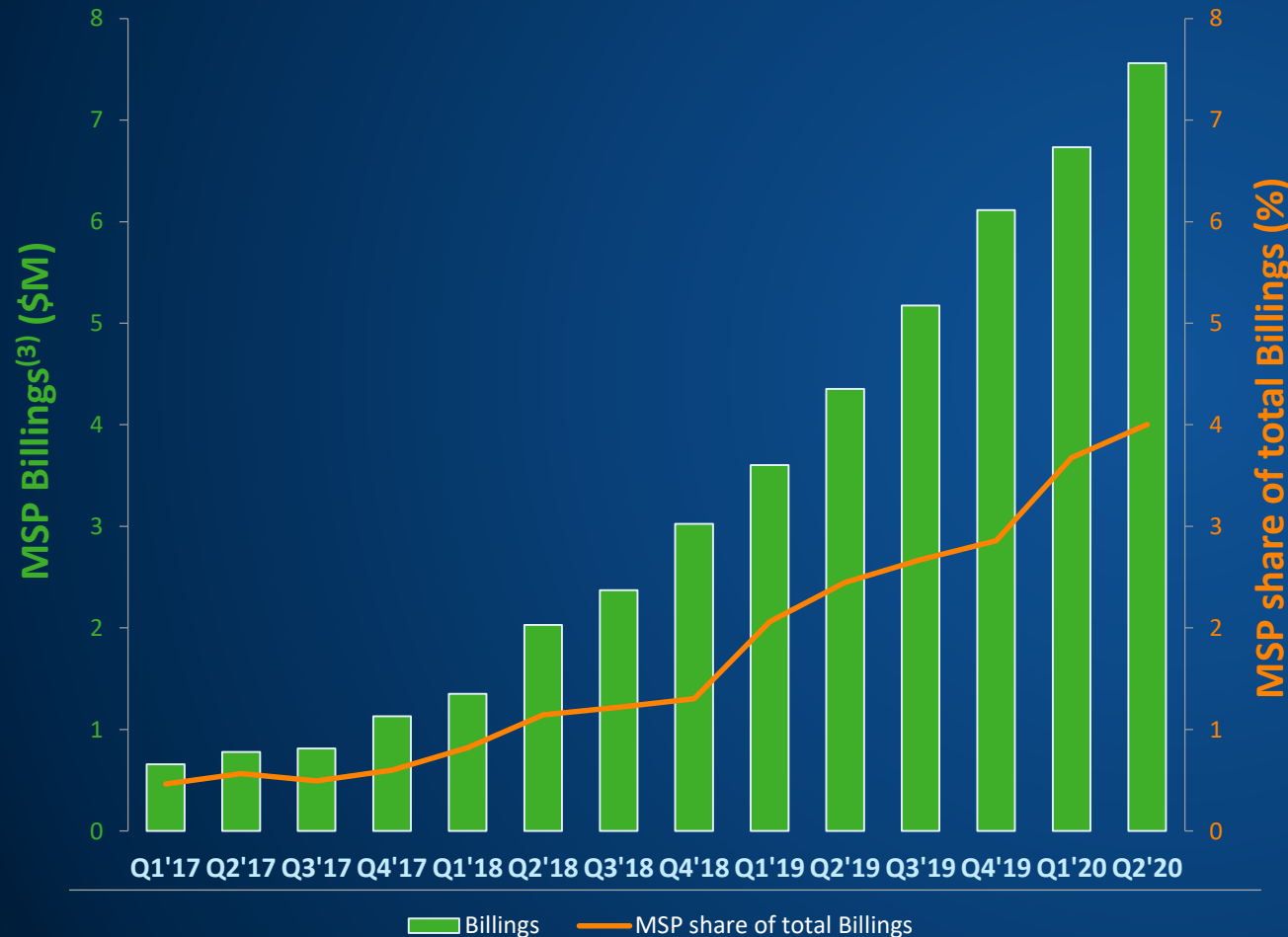
Absence of FY19 VPP payment  
Profitability improvement



# Continued Sophos Central Growth



# Managed Service Provider (“MSP”) Channel



- Sophos Central and Synchronized Security represent compelling offering for MSP partners
- Particularly attractive model for smaller customers
- MSP business is billed monthly and recognized to revenue immediately
- MSP billings<sup>(3)</sup> in Q2 FY20 equate to \$32.8 million in ARR
- Sophos MTR provides an additional opportunity for MSP partners

# Consistent Growth in Number of Customers



- **Term customers:** closed H1 with 347K term customers (excluding MSP customers), compared to 317k a year ago
- **Total customers:** closed H1 with a total of 409K customers (including both term and MSP customers), compared to 353K a year ago



# Expert-Led Threat Response

## Managed Threat Response (“MTR”)

- Others Stop at Notification. We Take Action.
- 24/7 threat hunting, detection, and response delivered by an expert team as a fully-managed service.



Analyst-Led Threat  
Hunting and Response



Targeted Actions to  
Neutralize Threats



Complete Transparency  
and Control



# Financial Results

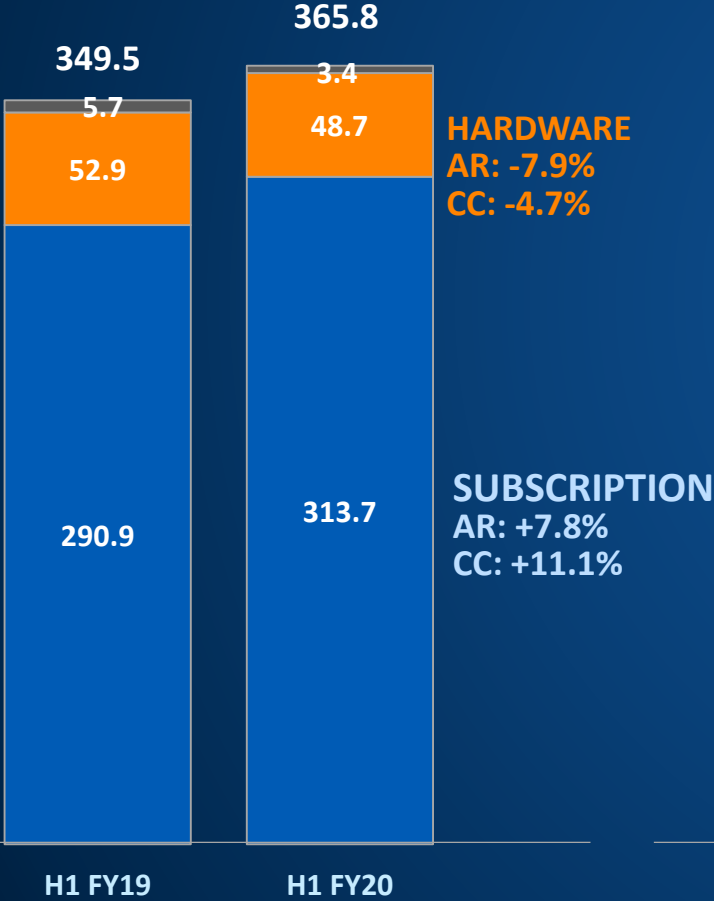
Nick Bray, CFO

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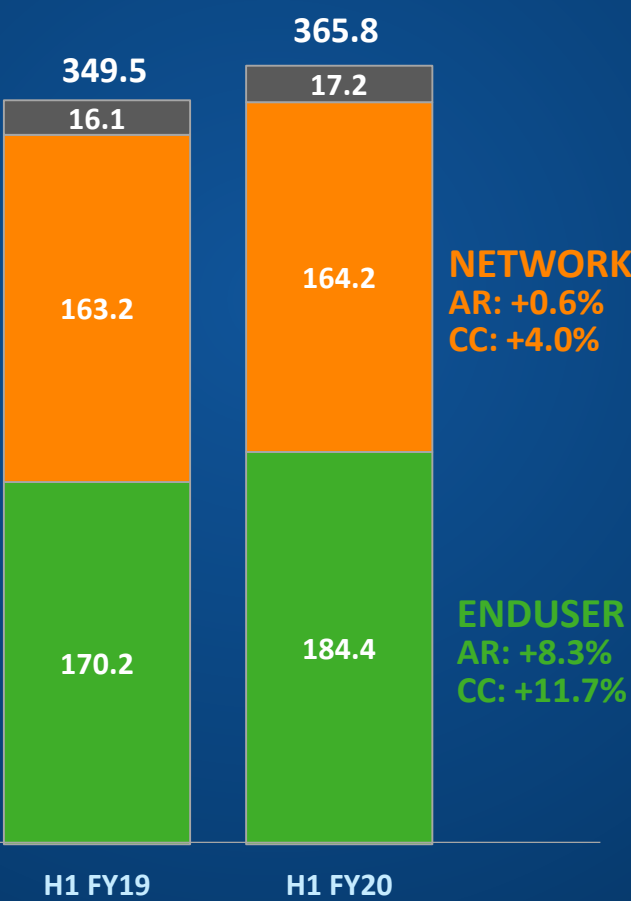
# Revenue Performance

Revenue growth of 4.7%, or 7.9% at constant currency

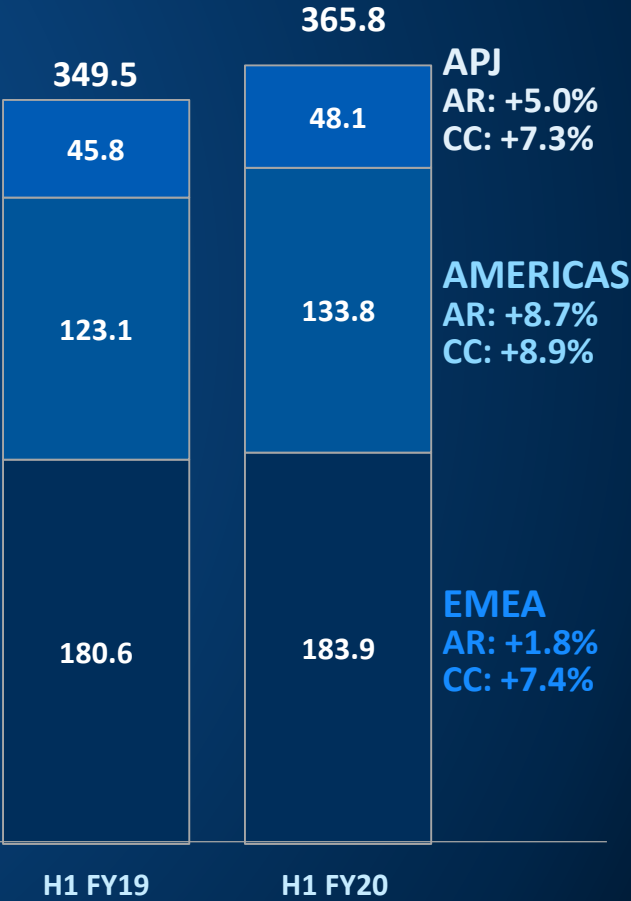
REPORTED REVENUE BY TYPE (\$M)



REPORTED REVENUE BY PRODUCT (\$M)



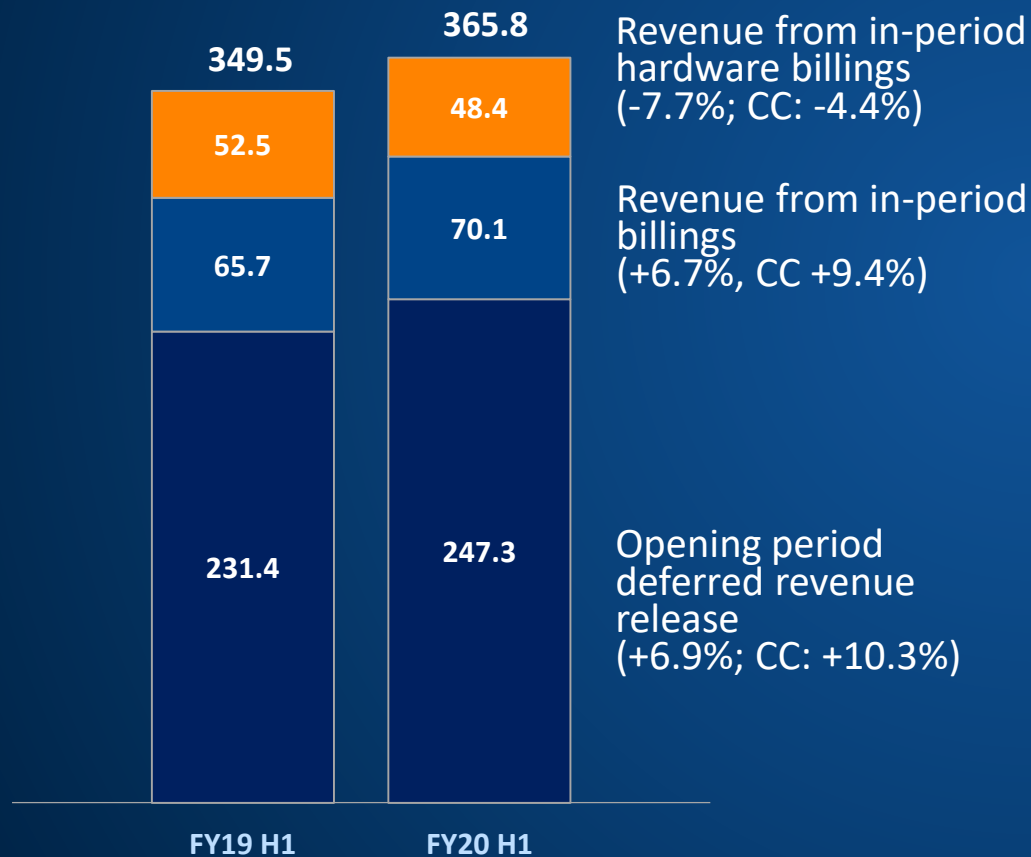
REPORTED REVENUE BY REGION (\$M)



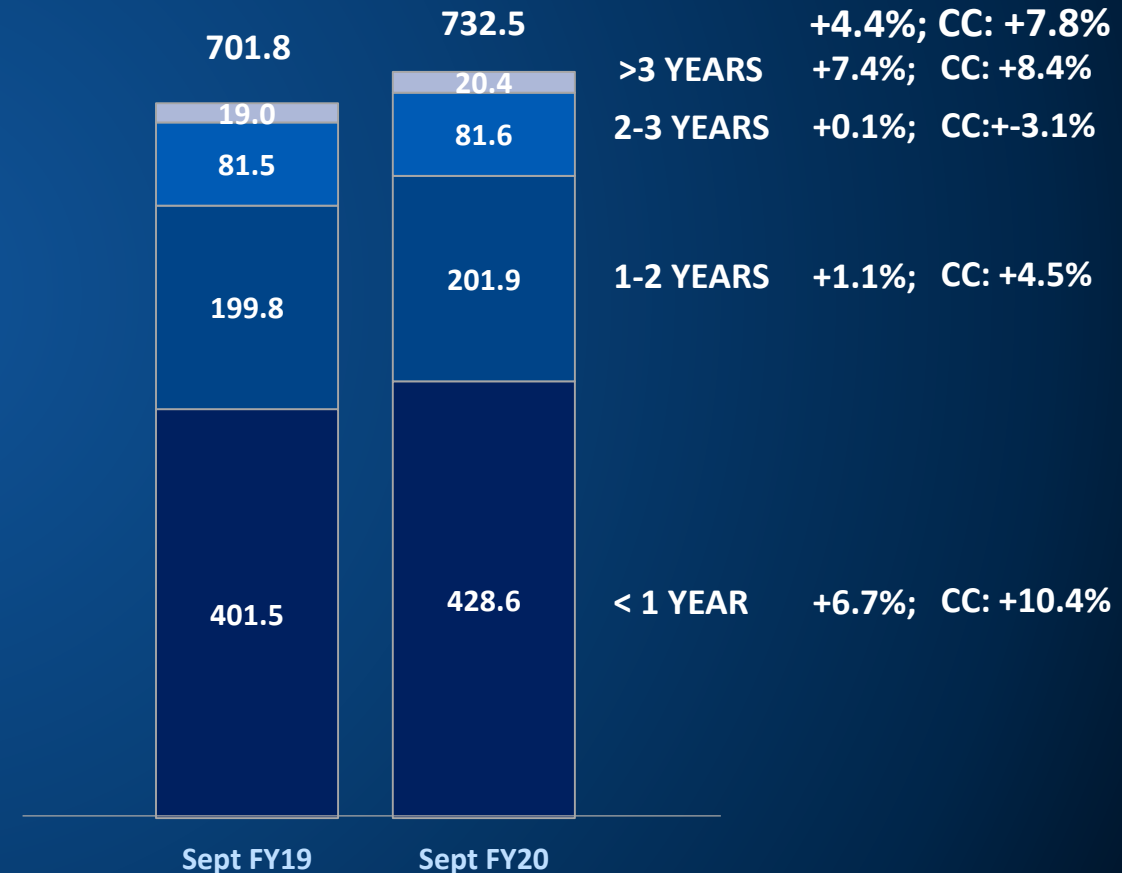
# Revenue by Year of Recognition

*Deferred revenue growth driven by subscription billings growth, partially offset by FX*

REPORTED REVENUE BY SOURCE (\$M)



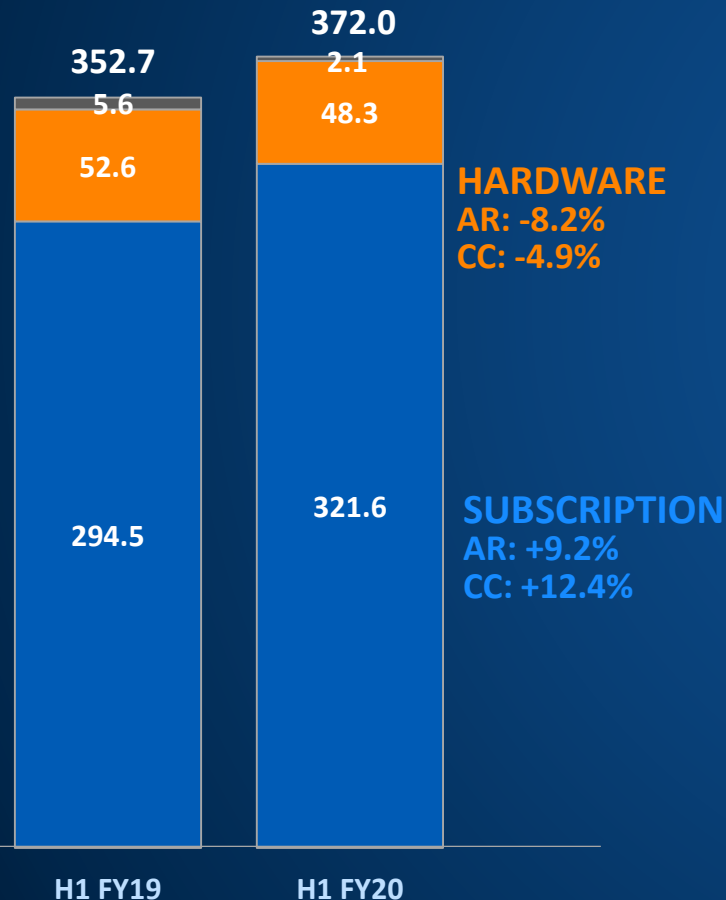
DEFERRED REVENUE (\$M)



# Billings Performance

*Subscription billings<sup>(1)</sup> growth of 12.4% at constant currency, or 9.2% at actual rates*

## REPORTED BILLINGS BY TYPE (\$M)



## BILLINGS DRIVERS

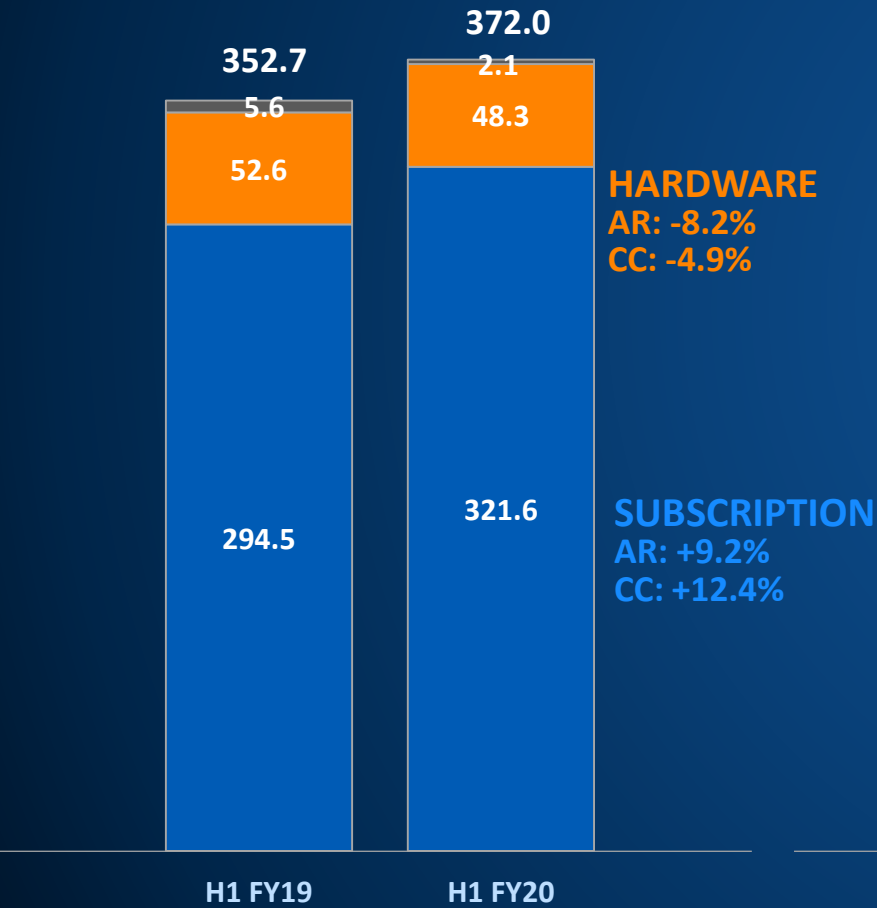
- Brand new customer billings<sup>(7)</sup> up 6% at constant currency
- Mix shift with larger transactions remaining stable and growing MSP business (smaller customers, monthly billings)
- Existing customers renewal rates<sup>(8)</sup> at 121% (H1 FY19 118%)
- High visibility of the renewal book<sup>(9)</sup>



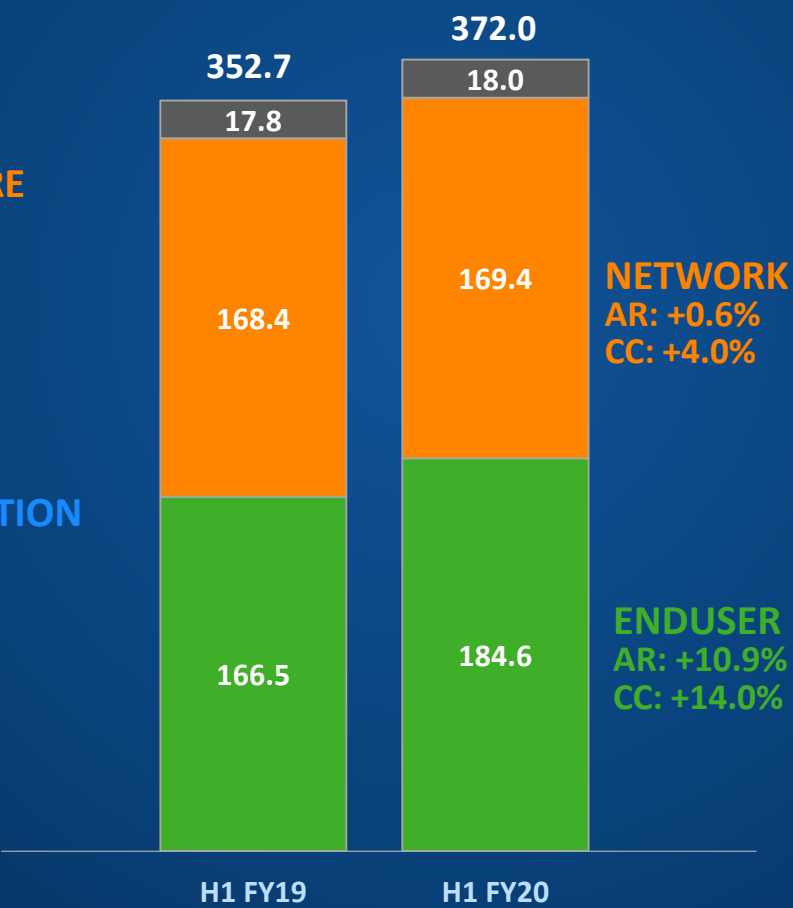
# Billings Performance

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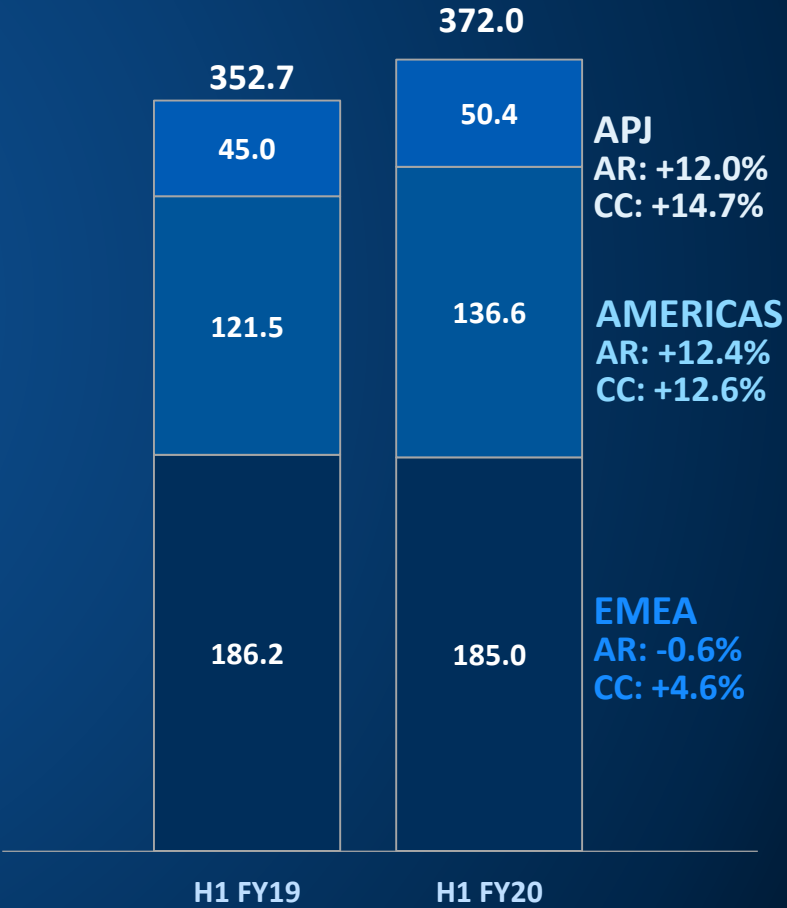
REPORTED BILLINGS BY TYPE (\$M)



REPORTED BILLINGS BY PRODUCT (\$M)

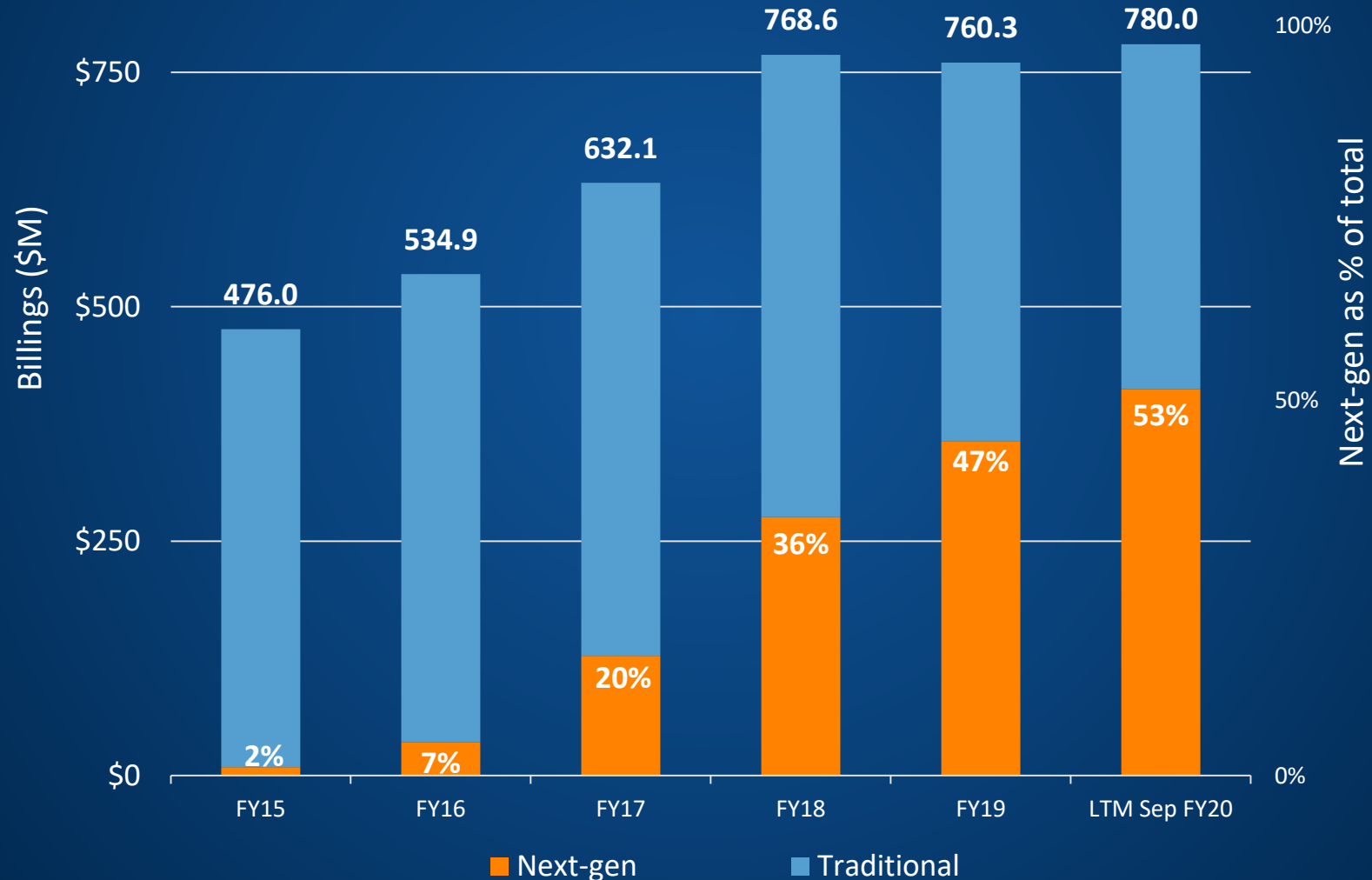


REPORTED BILLINGS BY REGION (\$M)



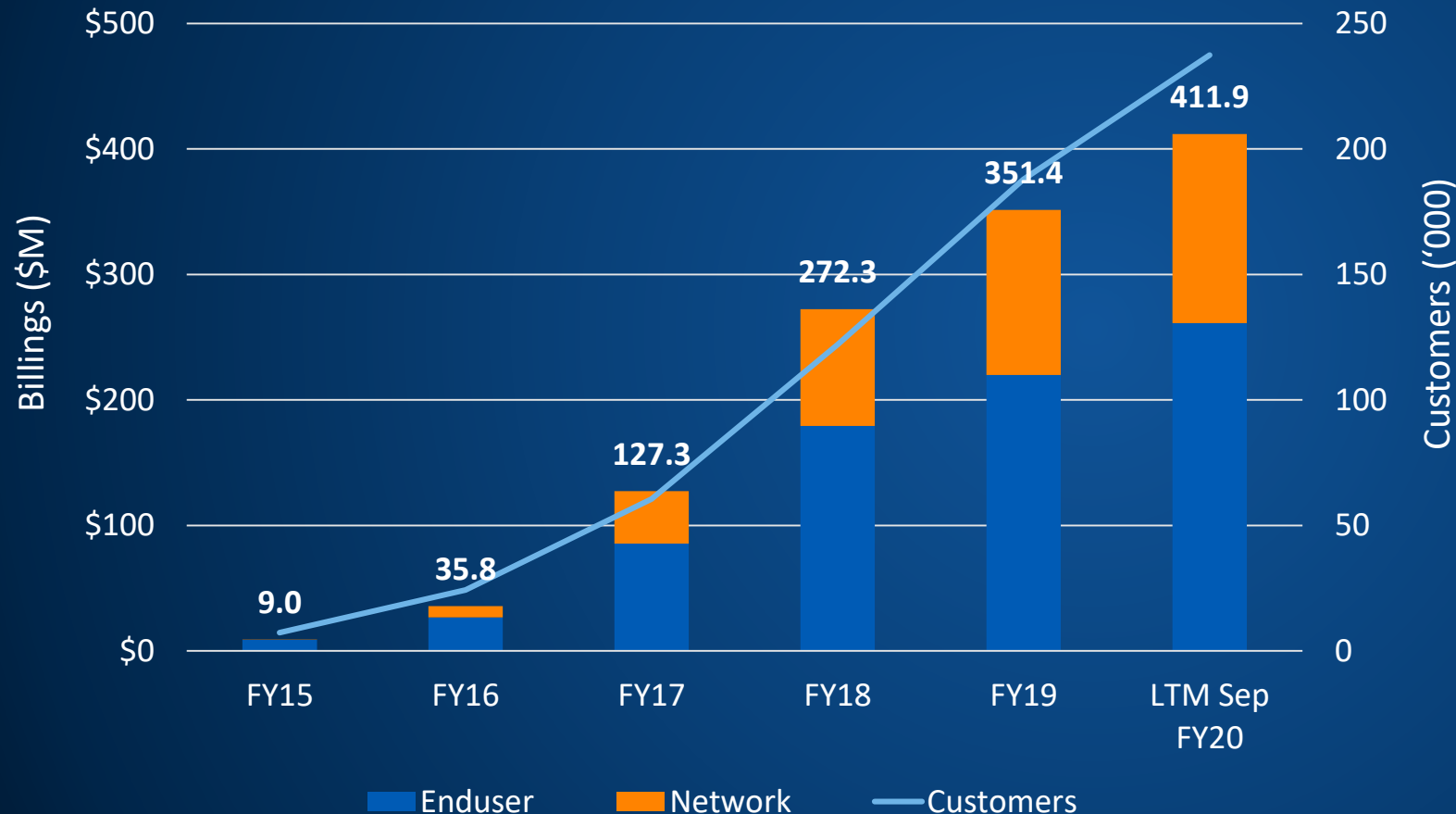
# Next-Gen Transition

*Continued strong growth in next-gen products; 40% at constant currency in H1 FY20*



# Next-Gen Portfolio Progress

*Next-gen growth in both Enduser and Network*

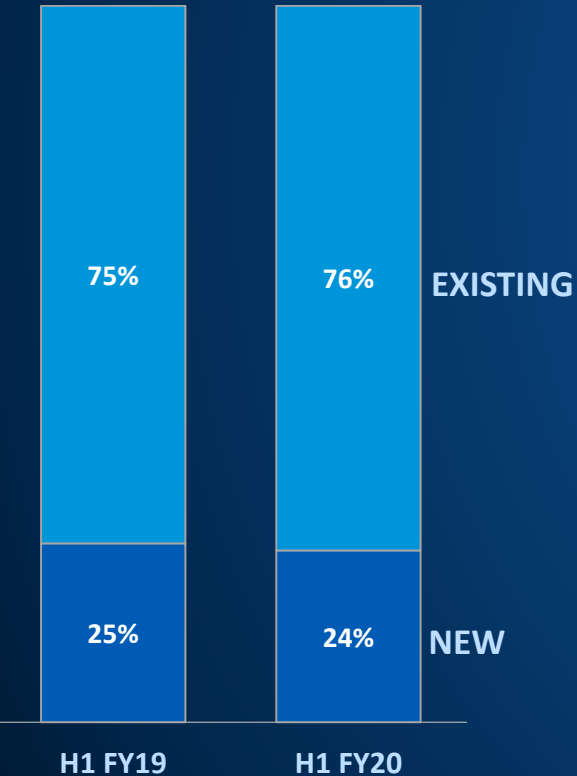


- Net increase in next-gen customers in H1 FY20 of over 45,000 (incl. MSP)
- c.95% of new customer business in Endpoint is next-gen, and c.65% in UTM/firewall

# Key Billings Metrics

Continuing to see effects of MSP in the mix

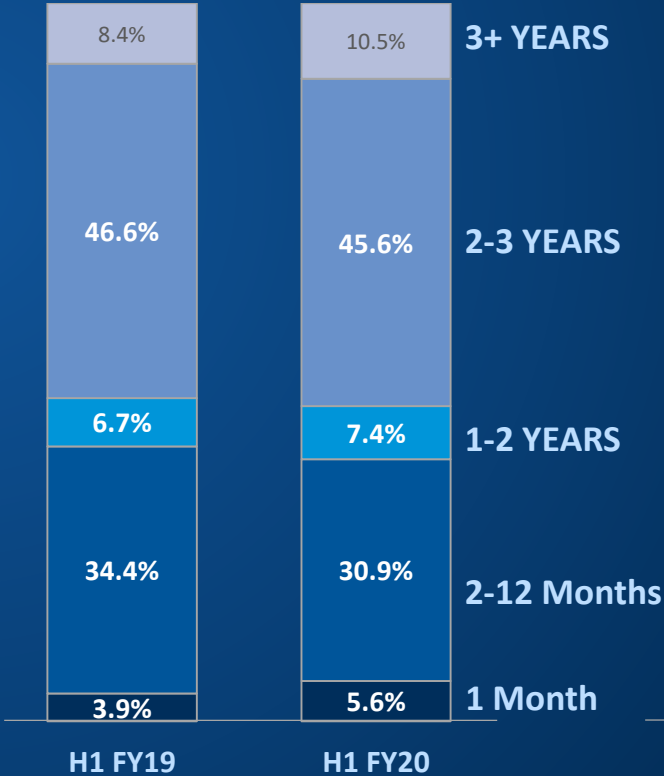
BILLINGS BY CUSTOMER TYPE



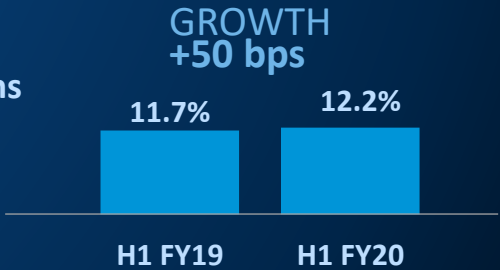
BILLINGS BY SIZE (Employees)



BILLINGS BY LENGTH OF CONTRACT<sup>(10)</sup>



PERCENTAGE OF CUSTOMERS WITH UTM AND ENDPOINT



Weighted average contract length<sup>(10)</sup> of 26.3 months, a small decrease on 27.2 months in the comparative period

# 5-Year Renewal Rate

*Renewal rate driven by cross-sell*



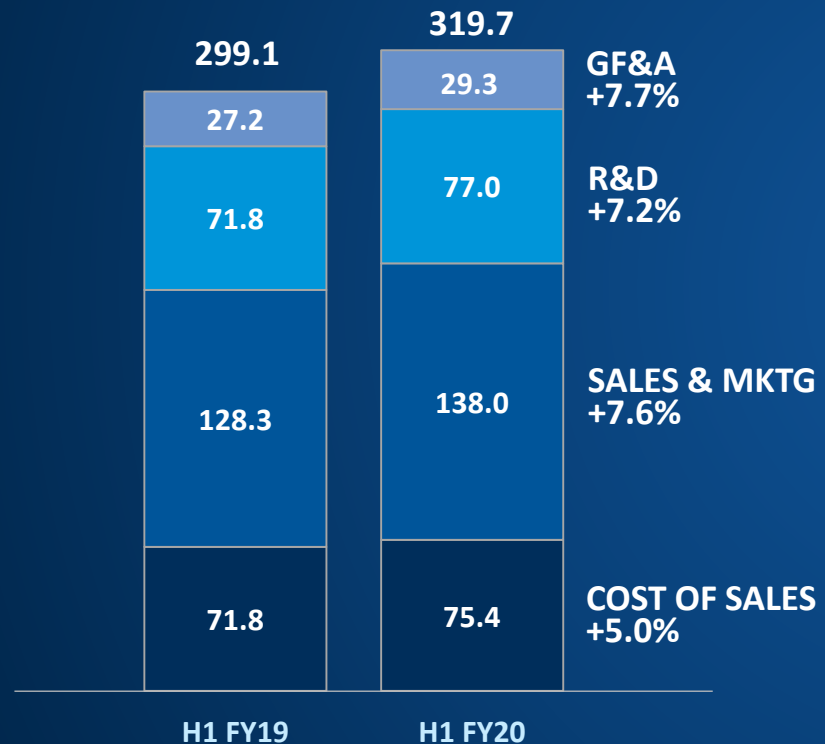
- Renewal rate is difficult to predict as it is an output, particularly affected by levels of cross-sell in the period
- Cross-sell opportunity remains, with current year benefiting from CIX Advanced EDR, MTR, plus Sophos Central management and Synchronized Security on the XG firewall



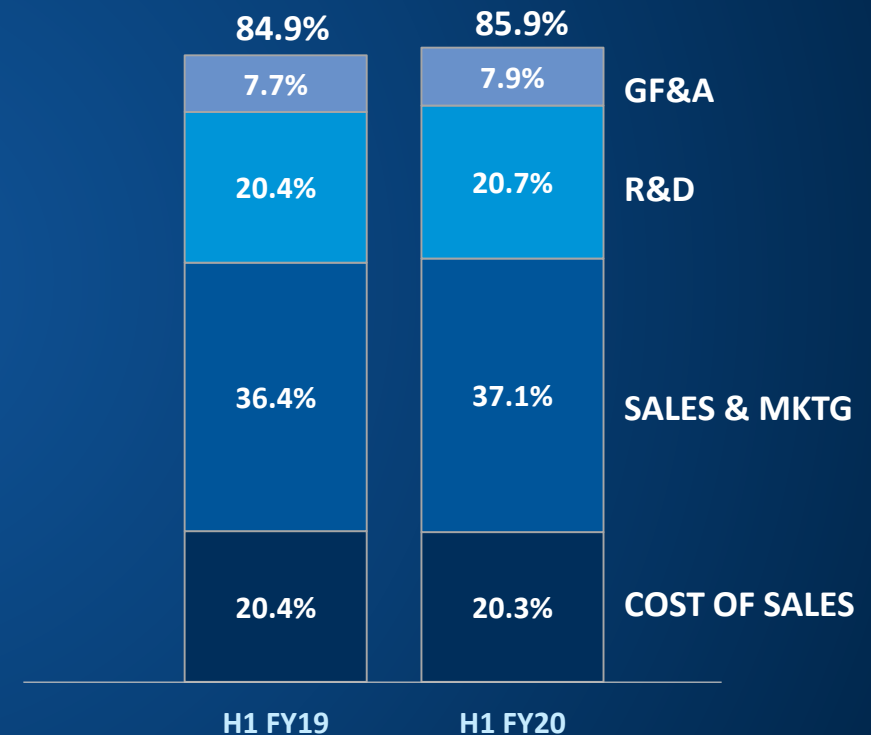
# Expense Performance

*Costs as a proportion of billings largely stable; with continued investment in go-to-market*

COST ANALYSIS (\$M)<sup>(11)</sup>



COSTS AS % OF BILLINGS<sup>(11)</sup>



# Cash EBITDA and Statutory Income Statement

*23.7% increase in CEBITDA; driven from both IFRS 16 impact and underlying trading*

CASH EBITDA RECONCILIATION			
\$M	H1 FY19	H1 FY20	
Cash EBITDA	54.0	66.8	
Net deferral of revenue and selling costs	(4.0)	(4.9)	
Depreciation	(5.8)	(12.8)	
Unrealised foreign exchange loss	5.7	0.3	
<b>Adjusted operating profit</b>	<b>49.9</b>	<b>49.4</b>	

STATUTORY INCOME STATEMENT			
\$M	H1 FY19	H1 FY20	
Billings	352.7	372.0	
Net deferral of revenue	(3.2)	(6.2)	
<b>Revenue</b>	<b>349.5</b>	<b>365.8</b>	
Cost of sales	(72.9)	(75.4)	
Gross profit	276.6	290.4	
Sales and marketing	(131.0)	(136.7)	
Research and development	(74.0)	(77.0)	
General finance and administration	(27.7)	(29.3)	
FX profit/loss	6.0	2.0	
<b>Adjusted operating profit</b>	<b>49.9</b>	<b>49.4</b>	
Amortisation	(7.8)	(10.3)	
Share based payment expense	(20.6)	(20.4)	
Exceptional items	5.5	(14.3)	
<b>Operating result</b>	<b>27.0</b>	<b>4.4</b>	
Net interest expense	(1.0)	(5.9)	
Result before tax	26.0	(1.5)	
Tax	(15.0)	(6.1)	
<b>Result for the period</b>	<b>11.0</b>	<b>(7.6)</b>	

# Cash Flow

*Focused management of working capital and benefit from IFRS 16*

## ADJUSTED OPERATING PROFIT TO UFCF RECONCILIATION

\$M	H1 FY19	H1 FY20
<b>Adjusted operating profit</b>	<b>49.9</b>	<b>49.4</b>
Net deferral of revenue and costs	4.0	4.9
Exceptional items*	(1.4)	(6.7)
Depreciation	5.8	12.8
Unrealised foreign exchange	(5.7)	(0.3)
Change in working capital	36.4	40.3
Cash tax	(7.5)	(6.6)
<b>Net cash from operating activities</b>	<b>81.5</b>	<b>93.8</b>
Exceptional items*	1.4	6.7
Capex	(11.3)	(10.1)
<b>Unlevered FCF</b>	<b>71.6</b>	<b>90.4</b>

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

- **Operating Cash Flow**

Cash flow from operating activities increased by \$12.3 million to \$93.8 million

- **Working Capital**

Focused management of working capital, with DSOs flat YOY at 42 days

- **Capex**

Modest decline in Capex YOY, mainly due to the timing of planned expenditures

- **IFRS16**

Application of new lease accounting treatment also benefited cash flow in the period, excluding this the growth in Operating Cash Flow was 6% YOY

# Summary

Kris Hagerman, CEO

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# Summary: H1 Performance

- Continued top-line growth in revenue and billings
  - Subscription business remains the key driver
  - Growth across Enduser, Network, new business, and MSP
- Further progress in next-gen transition
  - Customers are better protected with next-gen cybersecurity
  - Clear benefits to business models of our partners, our customers, and Sophos
- Cross-sell billings are supporting subscription renewal rates
  - Sophos Central underpins the cross-sell strategy
  - We continue to innovate: key recent releases include Sophos MTR and Sophos XG Firewall v18 EAP
- We continue to execute on an effective and differentiated strategy



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Cybersecurity evolved.

**Q&A**

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# Impact of IFRS 16

## Improvement in measures

IFRS 16 impact statement	H1 FY20			H1 FY19		Growth	
	Reported \$M	IFRS 16 \$M	Excl. IFRS 16 \$M	Reported \$M	Incl. IFRS 16 %	Excl. IFRS 16 %	
<b>Operating result</b>	<b>4.4</b>	<b>(0.7)</b>	<b>3.7</b>	<b>27.0</b>	<b>(83.7%)</b>	<b>(86.3%)</b>	
Amortisation of intangibles	10.3	-	10.3	7.8			
Share-based payments – equity settled	20.4	-	20.4	20.6			
Exceptional items	14.3	-	14.3	(5.5)			
<b>Adjusted operating profit</b>	<b>49.4</b>	<b>(0.7)</b>	<b>48.7</b>	<b>49.9</b>	<b>(1.0%)</b>	<b>(2.4%)</b>	
Depreciation and unrealised FX	12.5	(6.7)	5.8	0.1			
Billings deferral	6.2	-	6.2	3.2			
Related selling costs deferral	(1.3)	-	(1.3)	0.8			
<b>Cash EBITDA</b>	<b>66.8</b>	<b>(7.4)</b>	<b>59.4</b>	<b>54.0</b>	<b>23.7%</b>	<b>10.0%</b>	

- Both the operating and adjusted operating result benefit by the net removal of \$7.4M of lease payments, replaced by \$6.7M of depreciation on the right-of-use asset
- CEBITDA, UFCF and cash from operating activities all benefit from the removal of \$7.4M of lease payments
- An additional \$1.3M interest expense is recognised in the period
- Hence net impact on profit before tax of \$0.6M

# End Notes

- (1) 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.
- (2) 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.
- (3) MSP Billings exclude Reflexion.
- (4) Adjusted operating profit represents the Group's operating profit/(loss) adjusted for amortisation charges, share option charges and exceptional items
- (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) Expenses included within the definition of cash EBITDA at actual exchange rates.

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