

# Q1 2017 SecureWorks Corp Earnings Call

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Saket Kalia, Barclays Capital - Analyst

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# PRESENTATION

## Operator

Good morning, and welcome to the SecureWorks first-quarter FY17 financial results conference call.

(Operator Instructions)

As a reminder, this conference call is being recorded. I would like to turn the call over to Rebecca Gardy, Head of Investor Relations. You may begin.

**Rebecca Gardy**, SecureWorks Corporation - Head of IR

Thank you. Good morning, everyone, and thank you for joining us today to discuss SecureWorks' financial results for the first quarter of FY17. This call is being recorded. This call is also being broadcast live over the Internet and can be accessed on the investor relations section of SecureWorks' website at [investors.SecureWorks.com](http://investors.SecureWorks.com). This webcast will remain available for replay until 5 PM Eastern time on June 30, 2016.

Before this call, SecureWorks issued a press release announcing results for its first quarter ended April 29, 2016. You can access this press release on the investor relations section of the SecureWorks website.

During this call, Management will make forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include guidance with respect to GAAP and non-GAAP revenue and net loss per share, as well as adjusted EBITDA.

Our forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those anticipated by these statements. You can find a description of these risks and uncertainties in today's earnings press release as well as the final IPO prospectus we filed with the SEC on April 22, which is available on our investor relations website and on the SEC's website.

All forward-looking statements made on this call apply as of today, and you should not rely on them as representing our views in the future. We undertake no obligation to update our forward-looking statements after this call.

Some of the financial measures we use on this call are expressed on a non-GAAP basis. We have provided reconciliations of the non-GAAP financial measures to GAAP financial measures in today's earnings press release available on our website.

With us today is Michael Cote, President and Chief Executive Officer of SecureWorks, and Wayne Jackson, Chief Financial Officer. Following their prepared remarks, we will take your questions. We would appreciate you limiting your initial questions to two so that we may allow as many of you to ask questions as possible in our allotted time.

In the event you have additional questions that are not covered by others, please feel free to re-queue, and we will do our best to come back to you. Thank you for your cooperation on this. With that, I would like to turn the call over to Mr. Michael Cote.

**Michael Cote**, SecureWorks Corporation - President and CEO

Thank you, Rebecca, and good morning, everyone. Welcome to SecureWorks' first-quarter earnings call, our first call as a public company and the first quarter in our history with \$100 million in revenue.

What an incredible journey it's been getting to this point. Although we are a new public company, SecureWorks has a 17-year track record as a global leader in cyber security. Yet, it's not how far we've come, it's how much opportunity still lies ahead that truly excites us.

For those of you that are relatively new to our story, SecureWorks is a global leader in providing intelligence-driven information security solutions. Our software-driven technology platform analyzes our clients' security data to discover malicious activity and deliver countermeasures, actionable intelligence, and valuable context.

We have a unique set of technology, intelligence, and expertise that provides the best protection strategy for our clients by enhancing their existing security measures. These are capabilities that organizations cannot replicate on their own.

The number and complexity of the attacks, incidents, and losses as a result of cybercrime increases every year. In April, we published our third annual Underground Hacker Markets Report. Our security experts found that these illicit markets are thriving and continuing to monetize every possible piece of business and personal data. The report highlighted the latest activities occurring in the darkest corners of the Internet and provided insights into the types of data and services being sold.

Cybercrime has no boundaries. Companies around the globe, from small businesses to the largest multinational organizations, are targets. The economic, regulatory, and reputational risk is significant and growing, and boards and C-suites are now making this a priority.

Organizations routinely invest in security point products, such as firewalls, intrusion detection and prevention devices, and endpoint agents. Most companies put in place multiple layers of point products, and they hire people in the hopes of strengthening their defense posture. Yet, despite all this effort, many still get hacked.

The hacker's goal is to circumvent the technology and detection, going unnoticed while living on the networks, stealing anything and everything of value. Security point products are an important aspect of a strong defense strategy. However, point products alone are not the answer.

One of the key attributes of our business model is that we are vendor agnostic. We partner with over 100 of the best-of-breed security technology companies.

Unlike point products that address a specific technology issue, we attack the problem holistically. This is because Internet security is a problem that will never be solved. We are dealing with human beings, we call them threat actors, who use technology as their weapon to attack targets by constantly evolving their tactics, techniques, and procedures.

Over the last 17 years, we have continuously evolved our technologies and solutions, leveraging our proprietary software-driven technology platform, which we refer to as the Counter Threat Platform, or CTP. This platform leverages the intelligence we have gained from serving over 4,300 clients of various sizes and complexity across 59 geographies and multiple industries. We analyze our clients' security data to discover malicious activity and deliver countermeasures, dynamic intelligence, and valuable context.

Each day the CTP analyzes the log data from our clients' devices, including their security point products. For a perspective on just how much data we are talking about, currently, the CTP aggregates over 180 billion events a day, and this number has historically doubled approximately every 16 months.

The key elements of our intellectual property are, first, our advanced analytics, data sciences, and machine learning algorithms. All of this in-depth analysis happens in mere seconds. The CTP analyzes greater than 99.99% of the events without any human intervention. After we take action and notify our client, our complete analysis and the results of the action are then codified and fed back into the CTP to continuously improve the detection and response to future attacks for all our clients.

Second, the visibility we have into the global threat landscape and the network effect that results. The CTP scales as our business grows and the number of threats increases. As our client base grows and the number of events analyzed increases, our global visibility into the threat landscape is enhanced, enabling the CTP to become even more effective at providing an early warning against threats.

And third, our vendor-neutral approach. Put simply, we orchestrate across our client security devices applying our intelligence. We partner with clients, leveraging intelligence from the spectrum of point products they already have installed in their IT infrastructure, including taking feeds from their security information and event management system.

Our model delivers great value by being flexible and offering full transparency. With this powerful combination, we know what threat actors are targeting and how their attacks are propagating across the Internet, often before large-scale breaches are even reported, providing an early warning and response capability. There are hundreds of vignettes that I could share with you to illustrate the many ways we add value to our clients. Let me share just a few examples from the first quarter.

First, we're helping a small but fast-growing chemical production company who has recently grown through acquisition and is now faced with the challenge of securing disparate systems both on prem and in the cloud. The advanced analytics capabilities of our counter-threat platform allow us to support their existing investments in security infrastructure and provide them with a centralized and uniform platform for visibility and orchestration across their expanding organization.

Here is a second example. We're helping a state government organization not only protect itself, but also an additional 120 agencies under its umbrella. The sheer volume of alerts, the lack of security skill set on staff, and the ever-growing sophistication of bad actors prompted this client to partner with us. Our CTP analyzes the log data from their over 220 servers, including elastic servers in the cloud, 15 firewalls, and five intrusion detection and prevention devices, in a vendor-neutral way and create actionable intelligence, which we apply across these security devices.

And lastly, I'll call out an investigation involving several of our clients across multiple verticals, which speaks to the power of the global visibility that our threat intelligence platform brings. Our counter-threat unit's research into threat actors repurposing legitimate tools for malicious intent uncovered suspicious remote access activity.

We were able to leverage our Advanced Endpoint Threat Detection Red Cloak solution and our historical database of logs to discover multiple clients impacted on a previously unknown threat across the industry. A multitude of clients were quickly notified of adversaries taking advantage of legitimate software functionality. New research into threat actors living off the land was transitioned to client protections within hours.

The key takeaway from these brief examples is that our solutions fit the needs of our clients, spanning from the largest organizations in the world, as well as small and medium-size businesses, across industry sectors, geographies, and complexity. We believe the best defensive strategy is to analyze the tactics, techniques, and procedures used by threat actors across the entire threat landscape and then develop solutions using best-of-breed technologies to protect our clients.

As I mentioned, we work with the spectrum of our client's security point products and apply countermeasures across these devices, ultimately strengthening their security posture. All our clients benefit from our global visibility and the network effect because they are all connected to the CTP, regardless of what their security point products are that they have in place. And that is what makes our value proposition to our clients unrivaled.

Now, let me turn it over to Wayne who will walk you through our first-quarter financial performance.

**Wayne Jackson**, SecureWorks Corporation - CFO

Thanks, Mike. Good morning, everyone. I will start with a review of our first-quarter results and then provide second-quarter and full-year guidance for FY17. The following financial results and metrics will be non-GAAP measures unless otherwise noted.

As we review the results, there are three items that I would like to highlight. First, revenue grew primarily as a result of continued growth in subscription contracts. Second, we improved our delivery efficiency during the quarter, resulting in gross margin expansion. And lastly, G&A expenses scaled as a percent of revenue as we have generally completed our buildout of our infrastructure to operate as a stand-alone public company. We are pleased that these results demonstrate solid progress on our path to profitability.

First-quarter revenue was \$100 million, a 28.1% growth rate over the prior year, primarily due to both the addition of new clients and expanded sales to existing clients. Our subscription revenue is derived from a diverse group of clients in terms of industry and geography.

In the first quarter, we continued to see rapid growth in the manufacturing and healthcare sectors. While our largest sector, financial services, also continued to grow, it declined slightly, to approximately 32% as a percentage of our subscription revenues, from 33% in the first quarter of FY16.

Approximately 12% of our revenue comes from clients based in countries outside the US. International revenue mix has not only provided financial diversification and a footing for future growth, but these international clients help enable us to see global security threats earlier so as to better serve all of our clients.

Gross margins improved to 53.6% of revenue during the quarter, a 170-basis-point increase year over year, as we saw the benefits of technology and scale in our delivery model. Sequentially, gross margin improved 230 basis points on strong revenue growth and flat cost of sales.

Operating expenses were 63.7% of revenue, down from 66.8% in the first quarter last year and 65.9% in the fourth quarter of our prior fiscal year. The largest drivers of this improvement were from general administrative expenses, which declined in absolute dollar terms sequentially.

Beginning in the second quarter of FY16, we invested heavily in the infrastructure to operate as a stand-alone public company. The technology, tools, and talent for that transition are now largely in place, and costs have begun to scale against revenue, both year over year and in sequential quarters.

As a percent of revenue, G&A in the first quarter was 22.7%, versus 23.4% in the first quarter last year and 24.5% in the fourth quarter of our prior fiscal year. Our sales and marketing expenses declined slightly, to 27.4% of revenue, compared to 28.3% of revenue in the first quarter last year. As we continue to invest in our sales teams to pursue growing client opportunities, sales and marketing expenses as a percent of revenue may fluctuate quarter to quarter depending on market-facing activity.

Research and development expenses were approximately 13.5% of revenue, which is consistent with recent quarters. We expect these expenses to stay around this range as we continue to invest in both client-facing and delivery technologies, including our cloud offerings.

At the end of the quarter, we had nearly 2,100 employees, representing a growth of approximately 22.7% over the prior year and 2.1% sequentially over the prior quarter. Approximately half of the year-over-year growth was in operations.

Non-GAAP loss per share was \$0.09, compared to \$0.12 in the prior year. The improvement relates primarily to increased revenue, expanded margins, and improved G&A expenses as a percent of revenue. The GAAP net loss was \$11.6 million, or \$0.17 per share, compared to \$17.8 million loss, or \$0.25 per share in the first quarter last year.

Weighted average shares outstanding, both basic and fully diluted, was 70.3 million at the end of the first quarter. The average shares outstanding reflects the \$8 million IPO shares, employee awards granted in conjunction with the IPO, and approximately two million shares from the conversion of debt. Total outstanding shares were 80.7 million at the end of the first quarter.

The Company's adjusted EBITDA loss in the first quarter narrowed to \$7.6 million, versus an adjusted EBITDA loss of \$11.1 million in the fourth quarter, on strong revenue flow through, increasing gross margin, and scaling G&A expenses.

Our cash position has improved significantly to approximately \$124 million at the end of the fourth quarter. This reflects our receipt of \$100 million in net proceeds from the IPO, a \$10-million investment from our parent in the first quarter prior to the IPO. In addition, we have an untapped \$30-million credit facility and no indebtedness. Effective upon the completion of our IPO, the \$28 million in debt reflected on our fourth-quarter balance sheet converted into common stock.

Cash flow used in operations was \$16.2 million, principally driven by the payment of annual bonuses in this quarter. On a trailing 12-month basis, cash used in operations was \$17.9 million. And finally, our capital expenditures were \$3.5 million in the first quarter.

Now, let me highlight our key operating metrics. Our subscription client base increased by 10% from the prior year, to approximately 4,300 clients. Monthly recurring revenue, or MRR, from our subscription business was \$28.9 million, up over 20% from \$24 million in the first quarter of last year. On a sequential-quarter basis, MRR grew approximately \$400,000, or 1.3%.

MRR represents the monthly value of our subscription contracts, including both installed revenue and operational backlog, as of the end of the quarter. We generally experience some variability in our MRR due to the timing of sales, the size and complexity of our installations, and client readiness. In the first quarter, the conversion of signed contracts to revenue recognition remained on pace, and in this quarter, the timing of several large contracts pushed into Q2.

Our revenue retention rate is an important measure of our success in retaining and growing revenue from our managed security clients. For the first quarter, our retention rate was 99%, as compared to an annual rate of 102% as measured at the end of each of the first and fourth quarters of FY16. Our revenue retention rates may fluctuate quarter to quarter as a result of several factors, and our goal every year is an annual rate of 100% or greater.

For those on the call building financial models, I would like to point out that the fourth quarter of FY17 will have 14 weeks versus

the standard 13 weeks, as SecureWorks operates on a 52-53 week fiscal year. The next year this will occur is calendar 2022, which for SecureWorks is FY23.

I will now turn to our outlook for the second fiscal quarter ending on July 29, 2016, and full FY17. Based on the first-quarter performance and current market conditions, we expect the following results. For the second fiscal quarter, we expect revenue on both a GAAP and non-GAAP basis to be between \$100 million and \$102 million, net loss per share to be in the range of \$0.15 to \$0.17, and non-GAAP net loss per share to be in the range of \$0.07 to \$0.09. We expect 80.009 million weighted average shares outstanding during the second quarter of FY17.

For the full fiscal year, the Company expects revenue to be between \$423 million and \$425 million and non-GAAP revenue to be between \$424 million and \$426 million, net loss per share to be in the range of \$0.62 to \$0.66, and non-GAAP net loss per share to be in the range of \$0.30 to \$0.33, and adjusted EBITDA loss to be between \$28 million and \$32 million.

We also expect 77.635 million weighted average shares outstanding during FY17. Finally, as we continue investing for growth, we expect capital expenditures to be approximately \$20 million to \$22 million for the full year.

In conclusion, I am very pleased with the first quarter performance as we execute our strategy and build on strong financial fundamentals. We are well positioned to do what we do best, provide intelligence-driven information security solutions to our client. I will now pass the call back to Mike, who will give some closing thoughts before we open the call for questions.

**Michael Cote**, SecureWorks Corporation - President and CEO

Thank you Wayne. As you heard, we're off to a great start to our first fiscal year as a publicly traded company. Our leadership position is as much about our strategy as it is our day-to-day relentless focus, passion, and purpose.

There is not an organization in the world that is immune from cyber attacks, and the nature of the attack is changing every day. Ultimately, the value we deliver is to help our clients prevent security breaches, detect malicious activity that can't be prevented, respond rapidly when a breach occurs, and predict the tactics, techniques, and procedures the hackers are going to use next.

Wayne and I look forward to meeting and getting to know you over the next couple of months. On June 16, Wayne and I will be presenting at the William Blair Growth Stock Conference and hope to see some of you there. Thank you, and operator, please open the call for questions.

## QUESTIONS AND ANSWERS

**Answer – Operator:** (Operator Instructions)

Sterling Auty, JPMorgan.

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**Analyst:** Sterling Auty, JPMorgan - Analyst

**Question – Sterling Auty:** Thanks. Good morning, guys.

**Answer – Michael Cote:** Good morning, Sterling.

**Question – Sterling Auty:** I wanted to start with -- you gave some examples, but just wondering if you've seen any change in trends in terms of the new customers that are coming onto the platform in terms of why they are coming onto the platform and what size their initial engagement looks like.

**Answer – Michael Cote:** Sterling, this is Mike. I will take that.

In the last 90 to 120 days, I have visited all of our offices -- almost all of our offices around the world. I've been to the APJ region and got home Sunday from EMEA, and I've visited with clients and prospects throughout the US as well. What I'd tell you is the sales pipeline is as robust as it's ever been in the history of the Company.

There seems to be a lot more interest from larger organizations that we are working through the process with, but other than that, we continue to sell across the spectrum from small- to medium-size business through large organizations. I do think that the industry is progressing towards a level of maturity where there's more interest from the C-suite and a more sophisticated solution.

**Question – Sterling Auty:** Got it. And then my one follow up question. Wayne, we saw a lot of (technical difficulty) [line]. I know you've got the transition service contract with Dell through, I believe, August of next year. Can you remind us how much flexibility you have to reduce the amount of expense that would be going to Dell given the buildout that you've talked about in terms of getting the full buildout to be a public company?

**Answer – Wayne Jackson:** Hi, Sterling. Absolutely. Our transition service agreements are designed for flexibility.

First of all, relative to the TSAs, they are not significant to our overall operating expenses. They are an important part of our transition, and some of the services that Dell provides under the TSA are very important to us, but we have complete flexibility to transition whenever we're ready, and we've actually started doing that over the last six months and will continue to do so over the next six to 12 months.

**Question – Sterling Auty:** Thank you.

**Answer – Operator:** Saket Kalia, Barclays.

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**Analyst:** Saket Kalia, Barclays Capital - Analyst

**Question – Saket Kalia:** Hi, guys. Thanks for taking my questions here. First, for Mike, Mike, can you just maybe talk a little bit about the overall health of security spending?

We heard a couple of vendors, most recently Palo Alto Networks, talk about maybe some longer sales cycles this quarter. Obviously, not happening here, but especially coming off your trip internationally, what are you hearing from customers on their

overall willingness to spend on security this year?

**Answer – Michael Cote:** It feels, from the meetings I have had with both clients and with prospects, that there is a very -- there's a strong willingness to spend. I think they're trying to make sure that where they spend from a security perspective, they are getting a real return that they can report up through the C-suite.

As Wayne mentioned, we did see somewhat of a slow developing order cycle on the larger deals that we were chasing in the first quarter. But the pipeline is robust, as I said. We have more large opportunities in front of us than we've ever had, and it feels like people are very interested in improving their security posture and willing to spend.

**Question – Saket Kalia:** Got it. That's real helpful. Maybe just for my follow up, for Wayne.

Wayne, can you just talk a little bit about the international part of the business. I know you said it's about 12% of revenue, but can you remind us how that performed versus your expectations? And more importantly, how far are we from seeing the gross margin profile on that part of the business maybe start to approach what we see in maybe your more developed markets?

**Answer – Wayne Jackson:** Thanks, Saket. So relative to international, it is around 12% of our overall revenue, and our two largest regions and EMEA and APJ. We consider Canada, really, as an extended part of North America, so excluding Canada, it's EMEA and APJ.

As a percent of growth, given the smaller base, those regions, we are seeing growth probably in excess of our overall revenue growth, but not enough to, right now, to move our overall growth that much. Relative to long term, if that was the second part of your question, we believe and are focused on continued expansion.

Mike mentioned his travels. He goes to APJ and EMEA for a reason. We see opportunities there and expect it to continue.

**Question – Saket Kalia:** Got it. Very helpful. Thanks, guys.

**Answer – Michael Cote:** Thank you.

**Answer – Operator:** Melissa Gorham, Morgan Stanley.

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**Analyst:** Melissa Gorham, Morgan Stanley - Analyst

**Question – Melissa Gorham:** Great. Thanks for taking my question. Mike, I just wanted to follow up on your comments on the large deals that got pushed into Q2. It doesn't seem like it was macro related just related to your comments, so was that just timing, or was there some execution-related issues? And then have those deals already closed in Q2?

**Answer – Wayne Jackson:** Hi, Melissa. This is Wayne. I'll take that.

So the answer is you helped answer the question. I will give you the answer first. It is timing.

But relative to MRR, just to peel back a little bit, we do see variability, as I talk about in our prepared remarks. We do see variability in MRR due to the timing of sales, especially in the large deal space.

For those who have read the S-1 and are familiar with the different sectors, our small to medium business is a little more predictable, closes the sales cycle a little bit faster. The larger clients, everyone knows it takes the longer sales cycle to close those deals. So it is timing.

As Mike mentioned, and we can't emphasize enough, our pipeline is very strong. And then ultimately, the answer is it was timing, and we have seen some large deals close already in Q2 that were in the works in Q1.

**Question – Melissa Gorham:** Okay. That's helpful.

**Answer – Michael Cote:** Did that help, Melissa?

**Question – Melissa Gorham:** Yes, that's helpful. I just wanted some more color on that.

So my follow up question is just digging into the gross margin improvement. So a pretty good improvement on a year-over-year basis. When you talked about the delivery efficiencies and greater scale, can you maybe just dig in a little bit more on what you are seeing on the cost of goods side, and then how sustainable these improvements are for the rest of FY17?

**Answer – Michael Cote:** Certainly. So as everyone has had a chance to read the S-1, I keep referring back to the S-1 because what that highlights is we've made significant investments in a lot of areas, conscious investments in a lot of areas starting in FY16.

And many of those investments were on our technology platform, our Counter Threat Platform, the operating platforms within our client delivery model, and we started seeing the benefits of those already, seeing those in Q1. And this favorability in as far as the uplift in our gross margin from those investments, is reflected in our Q2 and our annual guidance. And then we benefited some from converting contractors on the consulting side, converting contractors to full-time employees.

So we saw some margin improvement in that as well. So those are the two biggest drivers. But basically, we're beginning to see the return on the investments that we talked about in the S-1.

**Question – Melissa Gorham:** Great. Thank you.

**Answer – Operator:** Rob Owens, Pacific Crest Securities.

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**Analyst:** Rob Owens, Pacific Crest Securities - Analyst

**Question – Rob Owens:** Great, and good morning. Dovetailing the gross margin question, then, mix obviously can affect this, too. Should we assume a relatively consistent mix, then, with the managed service versus the pro service?

**Answer – Wayne Jackson:** Yes. Rob, this is Wayne. Very consistent mix quarter to quarter.



**Question – Rob Owens:** Okay. And then the second, with the commentary around push outs in the MRR, just trying to get a little more granularity there in terms of maybe where backlog levels were exiting April.

Would you consider them consistent with where you were somewhat in the back half of the year? Higher? Lower?

**Answer – Wayne Jackson:** So one other -- relative to MRR, because this is our first public quarterly conference call, just to share, MRR, when I say variability just to give you a range, over the last 11 quarters, including this quarter, we've seen total MRR swing from -- this quarter is 1.5% -- but from 1% to as high as 10%, again over the last 11 quarters. So total MRR swings, and it swings primarily, again, for new sales and for, relative to the install piece, for contracts that have been installed.

And I just want to make sure everyone understands, as we go forward, we're going to see some swings given the swings in the sales. And that's all baked into our guidance, of course, that the overall for the year, we feel very confident about the predictability of our revenue, the predictability of our sales. And then to answer your question, the makeup of our MRR between installed and backlog, it fluctuates, so that's the results of, again, sales and installs.

**Question – Rob Owens:** All right. Thanks.

**Answer – Wayne Jackson:** Thank you.

**Answer – Operator:** Walter Pritchard, Citi.

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**Analyst:** Walter Pritchard, Citigroup - Analyst

**Question – Walter Pritchard:** Hi. Just follow up on that question. I know you're not breaking out SRC specifically, but can you talk about level of demand in that business, what type of growth you're seeing there versus MSS, and specifically on conversion rates around SRC business trending into MSS, any color there in terms of any change or additional success in that conversion?

**Answer – Wayne Jackson:** So our overall sales and our pipeline of -- let me start back over. So the mix between SRC and our Managed Security Solutions business, that mix from a sales pipeline perspective is consistent with prior years and prior quarters. What we're seeing -- and if your question is --

**Answer – Michael Cote:** I'm going to jump in, Wayne. I think the first part of the question, if I got it, Walter, was the demand we are seeing for consulting services. Is that correct?

**Question – Walter Pritchard:** Yes, and conversion. That and conversion into MSS, if that sales motion is continuing or any change.

**Answer – Michael Cote:** Yes, so I would say is we are seeing an increased demand from a consulting perspective in the market. I think there is a desire for people looking for more help. We are, as we've talked about previously, or at least on the road show [on MSS] we're governing that part of the business and only doing the things that make sense for us from a overall client contract perspective, or the second part of your question, what would lead into a subscription long-term relationship with a client.

So we are still seeing the same types of conversion rates we've seen in the past, or at least that's what we saw the first quarter, from a conversion rate from consulting into subscription. But there is an increased demand that we saw in the first quarter, or a group of opportunities that we saw the first quarter from consulting business opportunities.

**Question – Walter Pritchard:** And then just one other question on the international mix and the predictability there. Is that at all, the increased push in international, driving some of the volatility in MRR that you saw in the quarter?

**Answer – Wayne Jackson:** It's pretty much across the board relative to region. It's primarily related to large contracts, and we have large contracts around the world.

**Answer – Michael Cote:** Yes. There are large opportunities in front of us that have, even with the smaller size and scale we are, for an example, in APJ, there are large opportunities throughout the world.

**Question – Walter Pritchard:** Okay. Great. Thank you.

**Answer – Operator:** Gabriela Borges, Goldman Sachs.

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**Analyst:** Chelsea Jurman, Goldman Sachs - Analyst

**Question – Chelsea Jurman:** Hi. This is Chelsea Jurman on for Gabriela. Thanks for taking the question. Can you provide any update on the competitive environment and what you're hearing when you do end deals or when you may not be winning deals, what the differentiating factors are?

**Answer – Michael Cote:** This is Mike. Thank you, Chelsea, for the question.

From a competitive perspective, we've not seen a big change in the last quarter, if you will. We're still seeing the same group of companies we would see in an enterprise space around the globe or the regional players that exist. And I think the reason where we win typically relates to the focus of this being all we do in a vendor-agnostic way.

So we're the only one in the industry not trying to sell a point product, and the power of the Counter Threat Platform as clients or prospects get underneath and understand and see it. I was, to give you a specific example, was in Europe last week and had an opportunity with a very large European organization who we spent a couple hours with in our European security operations center and took them through what we do and how the Counter Threat Platform works. And they left extremely enthused and excited.

**Question – Chelsea Jurman:** Great. And then you mentioned that there has been increasing headcount, and so can you provide any update on what the productivity of the sales people are or how long that takes to ramp and when you expect that to be fully ramped?

**Answer – Wayne Jackson:** So from a sales force perspective and ramp of productivity, it's consistent this quarter from prior quarters. It does take our quota carrier salespeople time to ramp. We see they ramp quicker, faster in the small and medium business, and then it takes a little bit longer for them to ramp to full quota in our large enterprise segment.

**Answer – Michael Cote:** Let me just add to that, that from a strategic perspective, we're looking to grow, long term, the many multiples our existing size. So when you mentioned, I think, Wayne, that the sales force would be fully there, we are going to look to continue to invest in our go-to-market capabilities around the globe to continue to drive incremental revenue growth.

**Question – Chelsea Jurman:** Great. Thank you.

**Answer – Operator:** Philip Winslow, Credit Suisse.

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**Analyst:** Michael Baresich, Credit Suisse - Analyst

**Question – Michael Baresich:** Thanks. This is actually Michael Baresich on for Phil. Quick housekeeping question. Had you been profitable, what would your fully diluted share count have been if you have that number?

**Answer – Wayne Jackson:** So Michael, I'll get back with you on that. We need to get back with you and run the numbers because if you had a chance to read the S-1, we have some restricted stock awards and restricted stock units and some stock options. I'd hate to do that in my head on the fly here.

**Question – Michael Baresich:** Okay, sure. And then just a quick follow-up question. In terms of the -- you commented on gross margin improvement being across both sides of the business, the managed security and security risk consulting, just very generally, proportionally, how much of the improvement came from each, or was it more split between the two?

**Answer – Wayne Jackson:** We don't look at it that way. We look at it -- Mike and his team manage the business from a security perspective, full go to market. So we don't necessarily dissect it that way.

**Answer – Michael Cote:** And just to make sure provide clarity, I don't think we inferred that the margin expansion was one versus the other.

**Answer – Wayne Jackson:** It was both. It was both.

**Question – Michael Baresich:** Okay. Great. Thank you very much.

**Answer – Operator:** [Christina Blaney], UBS.

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**Analyst:** Christina Blaney, UBS - Analyst

**Question – Christina Blaney:** Good morning, Mike and Wayne. Thank you for taking the questions. Just wanted to touch on your relationship with Dell and how that's evolved from the standpoint of them being a distribution partner as well as the customer with respect to certain arms-length transactions. And a follow up for Wayne if I may.

**Answer – Michael Cote:** So I will take the first part of this, and Wayne, you can add if I miss anything. So our relationship with Dell, our partnership with Dell is they are a client. So we do provide part of our solution to them from a client perspective at an arms-length relationship now that we are in the position that we are in from a publicly traded company. And the exciting part to me is the continued referral base that the Dell sellers around the globe, in our partnership with them, have continued to help from a lead-generation perspective bring deals our way.

So we have continued to see growth in that. And as you would expect in any relationship, the better it works over time, the closer the individuals get together, the better works. So it's been very good for us, and we're excited about the future opportunities continuing to grow that over the coming years.

**Question – Christina Blaney:** That's very helpful. And a question for Wayne, the deferred revenue performance was strong in the quarter, perhaps a little bit lighter than what we were looking for.

Can you remind us how to interpret the deferred revenue and the ensuing billings metric in the context of your business? Understand to go from book to bill within the two- to three-month timeframe on average, so could you just help us contextualize how to view that metric?

**Answer – Wayne Jackson:** So thanks for the question. For us, relative to deferred revenue and accounts receivable and implied billing, we really don't run the business that way. Our accounts receivable and deferred revenue really are lumpy.

And I will give you one example. In Q4, we had two clients that prepaid, in total, \$13 million of contracts. We billed it in Q4; they paid under the normal terms in Q1.

Those types of prepayments -- while those two are a little large larger than we see, we have a lot of prepaids, about 45% of our contracts are prepaid -- creates this lumpiness. We really believe that MRR and the way we focus on the business, MRR is a better measure of predictability for our revenue.

**Answer – Operator:** (Operator Instructions)

Jonathan Ho, William Blair.

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**Analyst:** Jonathan Ho, William Blair & Company - Analyst

**Question – Jonathan Ho:** Hey, guys. Congratulations on the strong quarter. I just wanted to start out with a little bit more color in terms of the cross-sell and up-sell success that maybe you've seen with Red Cloak and some of the other products. I just wanted to get a sense of where we are tracking there.

**Answer – Michael Cote:** We've come out of the gate very strong with Red Cloak. And both -- the pipeline is, quite frankly, more robust than anything we've had as a new solution we brought to market. And the win rate and closed deals has been very strong.

And just to remind everybody, that's in endpoint solution that we will -- can use somewhat independently, but in many instances, we partner with some of the other best-of-breed endpoint technologies on the market, and it works very, very well.

**Question – Jonathan Ho:** Got it. And I just want to understand, was there anything unusual that impacted the renewal rate this quarter within the range that you expect? Is there seasonality on that renewal rate? Just wanted to get a little bit more color in terms of the 99%.

**Answer – Wayne Jackson:** So the measure we talk about in the prepared remarks, the revenue retention rate, 99% for this quarter. Let's go over, briefly, the calculation. So it's the clients at the beginning of the year, the revenues for those clients at the end of the year, divided by the same revenue base at the beginning of the year, so it's effectively same-store sales in a retail model.

The only reason I always like to go into that is there are certain registrants that do that differently, so ours is pretty straightforward. The renewal rate was strong, 99%. Our goal is 100%.

So we were pretty much within 100 basis points on target there. So consistent renewal rate, to answer your question.

**Question – Jonathan Ho:** Great. Thank you.

**Answer – Wayne Jackson:** Thank you.

**Answer – Operator:** Matt [Hedberg], RBC Capital Markets.

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**Analyst:** Matt Hedberg, RBC Capital Markets - Analyst

**Question – Matt Hedberg:** Hi, guys. Thanks for taking my questions. Mike, you guys partner well with other security vendors, and I know you don't act as a replacement for point products. But I'm curious, do customers see SecureWorks as a platform to help them consolidate or rationalize their security spending?

**Answer – Michael Cote:** That's a good question, Matt. And I think the high-level answer to that is probably yes, particularly those that have been with us for a while because we end up in conversations of how to help them come up with the best overall security posture.

**Question – Matt Hedberg:** That's great. And then, I believe last year, the channel was about 6% of your business. Can you talk to us about the investments being made there and what leverage you expect maybe internationally versus domestically?

**Answer – Michael Cote:** This is Mike again. So we're making investments from a channel perspective, and the channel for the most part and that 6% is referral organizations more than, if you will, resellers.

And the investments that we're making are mostly outside of North America, in the APJ and the EMEA markets, where we are looking for partners that we could do more referral-type agreements with and/or potential resellers who are also exploring opportunities and have signed a contract where we've embedded our technology in a process manufacturing. Companies, for example, process technology. So when they sell it, their salespeople can effectively refer to have us do the management and monitoring of those devices to look for bad activity that may happen.

And then we are exploring other opportunities where we could be in a position to be the back-end solution in certain of the markets that are smaller markets around the globe that we would not go after directly today. All of those are investment areas that we are in the process of.

There have been no large revenue -- or no substantial revenue that's come from any of those opportunities, and we're going to continue to work them over the foreseeable future. And I will be happy to report in the future our progress on that.

**Question – Matt Hedberg:** Great. Thanks, Mike.

**Answer – Operator:** Gur Talpaz, Stifel.

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**Analyst:** Gur Talpaz, Stifel Nicolaus - Analyst

**Question – Gur Talpaz:** Great. Thanks for taking my questions. So I was hoping you talk a little bit about automation rates. Do you see room for incremental improvements here, or have we simply flattened that with regard to what you can get out of CTU?

**Answer – Michael Cote:** Out of the CTP? Out of our technology?

**Question – Gur Talpaz:** Yes.

**Answer – Michael Cote:** This is Mike again, and thanks for the question. I would tell you that we invested over the last 18 to 24 months in putting technological improvements in place. They are not coming all at once but will continue to come over time.

**Question – Gur Talpaz:** That's fair. And then maybe just one way to finish it off. Maybe talk a little bit about the customer and employer response regarding both the IPO and the split from Dell, what you're seeing out there, what you've heard from folks on both sides.

**Answer – Michael Cote:** Great question. I would tell you that from an employee perspective, I think the employee base is excited to have the best of both worlds, the ability to continue to have our partnership with Dell and use the parts of Dell that can help us continue to grow and work with our clients, and yet have the agility of a smaller public company. So our employee base is excited about the opportunities that lie ahead of us.

From a client and prospect perspective, everything that we've heard has been very strong and positive. And again, people are excited about -- and the folks that I've met with around the globe in the last 90 to 120 days are excited about the investments we're making from a long-term perspective.

The fact that this is all that we do, so we are not confused when we wake up in the morning. We are purely focused to use the best security technologies on the market with our clients to keep the bad guys out of their network. So it's been positive all around, and we are, quite frankly, excited.

If I close this out, I would tell you that from my perspective, I think this is the first step in a long journey as we've executed on the first step in the phase. Although the quarter ended a little over 30 days ago, we moved on 29 days ago to focus on this quarter and



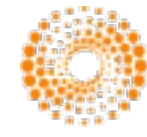
the execution of what we're going to do both in the second quarter and throughout 2017 and beyond. As an employee group, are extremely excited about where we are looking to go.

So with that, I'd like to thank everyone for their time this morning, and we appreciate you joining us on this call, and we'll talk to you again next quarter. Have a great day.

**Answer – Operator:** This concludes today's conference call. We appreciate your participation. You may now disconnect.

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