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WithSecure Corp. (FSC1V.FI)

Q2 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Laura Viita

Investor Relations Director, Laura Viita

Good afternoon and welcome to WithSecure. My name is Laura Viita. I am the Investor Relations of WithSecure, and happy to welcome you to this Quarter Two 2022 Results Release. Also the people watching us on the webcast, warmly welcome.

It is the first time we are doing this without our consumer business, and that's because of the demerger that actually took place on the last day of June. The new F-Secure will do their first results release in exactly one hour from now.

Our presenters today will be Juhani Hintikka, the CEO of WithSecure; and Tom Jansson, the CFO of WithSecure. We will have all questions and answers at the end. If you're watching the webcast, you can put in questions all the time. We will keep an eye on them and present them at the end.

With that, I'm handing over to Juhani Hintikka, the CEO of WithSecure.

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

Thank you, Laura. Good morning, good afternoon to everybody online, in the room, great to have you here and great to be also in this first independent WithSecure session. Our Q2 was characterized by strong, steady cloud revenue growth, and also a major, major topic for us was the conclusion of the demerger project, as Laura said, during the last day of June. We are now officially two independently trading companies in the Helsinki Nasdaq.

Some key takeaways from second quarter of 2022. So as said, we saw steady growth in cloud-native corporate security products, where our revenue grew by 32% year-on-year to the level of €16.8 million. Important metric for

us is the annual recurring revenue that also grew by 31% to the level of €67.5 million. Talking about the metrics like annual recurring revenue is important as we are increasingly becoming a software-as-a-services company, and this is one of our key metrics in tracking our progress towards that.

The Elements product portfolio was performing well. Some of you may remember that we launched it almost exactly one year ago, and that has really been taken well by the market and our partners overall. Interestingly, we are now seeing even more demand to a specific part of the portfolio, the EDR, Endpoint Detection and Response which, again, provides more functionality for more demanding customers, and that is looking especially strong now.

We also saw growth in MDR revenue. We saw the average deal size increasing, which is an important metric. This is high-touch business. We have direct Salesforce, so we want to see that happening as well, average deal size growing.

We did have an exceptionally strong first quarter as we communicated after that one. With that in the backdrop, of course, our Q2 orders did not quite match the expectations that we were setting for ourselves after this exceptionally strong Q1. But at the same time, the business is growing. It's doing well and we have already actually managed to close almost half of those deals that slipped to the third quarter during the first week of July. So, all good on that front.

The revenue of on-premise corporate security products had decreased as expected. So, we saw a decrease of 10%. You may remember that we have previously talked about the difference between the on-premise software products and the products that we deploy by using public cloud infrastructure. This is the on-premise part. And even though our development focus and our business focus is in the cloud portfolio, we still remain a number of important customers that for various reasons want to remain with the on-premise portfolio. And we are, of course, supporting them but this is a decreasing part of our portfolio.

Our consulting revenue on a comparable basis decreased by 13% to the level of €8.9 million. So, this is the level where we were roughly about maybe two years ago. And that – now, while this, of course, is a negative trend, the decrease and there is a certain softness in that, we have been quite successful actually in tackling the attrition and onboarding new consultants.

The attrition levels in the industry, in the cybersecurity industry, are estimated to be between 22% to 24%, so we're not alone in this environment where we see high attrition and people changing. And, of course, highly skilled consultants are a sought-after resource and all companies are trying to attract them. But at the same time, as said, we have been quite successful in onboarding – hiring, onboarding new consultants, and we expect to see an improvement also materializing in our delivery capacity and thus revenue towards the latter part of Q3.

Now, this is something that is also – forms an integral part of our portfolio. We're very committed in this business growing it, and the demand remains strong. So, we are primarily tackling this delivery aspect with consulting.

And thus the overall market, as you all know, the geopolitical situation remains tense. When we've been speaking at various industry conferences, the topic of the day is the war in Ukraine. And, of course, that's very much also a battleground for cybersecurity. And many of the things that we talk about are being put into real-life test and real-life use in Ukraine. And, of course, that in a sad way drives also some of the technologies forward, if you can say that.

But as said, strong demand overall for cybersecurity products and services continues. And, of course, this is also amidst the current sentiment in the market against the current turmoil that we are seeing in some other sectors. Cybersecurity is proving to be a fairly defensive sector overall. Companies are not so eager to cut down on cybersecurity investments and trying to find savings elsewhere where they have to that we are witnessing.

Land and expand strategy is important for us. That is about winning a customer and then expanding our presence in that customer either by addressing new departments or new divisions of a larger company or bringing in completely new products and services from our portfolio. And we are measuring this with so-called net retention rate, NRR, and clearly we are seeing strong performance from that KPI. And that means basically that how much more we are able to sell to our existing customer base.

And as said, demerger of consumer security business into F-Secure Corporation completed successfully. Now, a huge amount of work went into this, and I'm very thankful for our own personnel and our advisors that were working in that process, which ran roughly between October to the end of June, huge amount of work. And, of course, we're conscious of the fact that this is a largely technical exercise with a lot of work. It doesn't, as such, provide us with more business, but it gives us a good foundation for developing these two companies independently forward. And we have now started trading 1st of July in the Nasdaq as you have been able to witness.

There is one extraordinary item regarding the discontinued operations result of €459 million. I never expected to be able to announce that kind of a bookkeeping result, but that is there anyway. It's a bit of an anomaly amongst our numbers, but we're happy to take more questions around that later on.

Some other things to mention regarding second quarter, we did have the Sphere conference, which was what we called an un-conference, not a conventional conference, that was held here in Finland amidst the pandemic restrictions, a little over 350 participants from all over the world, very good reviews about the program, about the content. And we also – as some of you may have participated in those, but we also ran a separate media stream with over 50 journalists flying in from all over the world to participate. And we actually had over 300 articles published after that one, so really good media coverage.

In terms of our social media coverage, I'm also happy to report that we are currently tracking as number one company in Europe in the cybersecurity landscape in terms of our social media presence. And then, finally, we held a Capital Markets Day, as many of you know, we had that in June. We talked about our plans and our business in more detail. So, that's it in a nutshell, second quarter.

So, what I will be doing now, I will be handing over to our CFO, Tom Jansson. Tom will talk through the numbers, and then we will both be here when we will have the Q&A session at the very end. So, stay tuned and send your questions also while you're listening if you're online. So, over to you, Tom.

Thomas Jansson

Chief Financial Officer, WithSecure Corp.

Thank you, Juhani, and good afternoon and good morning to everybody on the line as well. So, if we talk a little bit more about our numbers. So, as you can see on an annual comparable basis, our cloud native revenue grew by 32% across many of our – most of our portfolio in that part. And obviously, we're quite okay with that sort of growth.

On the on-premise then, again, that decreased by 10% and that is also in line with what we have been expecting and communicating on in terms of what the expectations on our on-premise solution is going forward.

Then if we look at our ARR, as Juhani mentioned, it's obviously a very important metric to us. Our ARR grew about 31% on our cloud native part of our portfolio. And obviously, there was a – big driver for that was our Q1 and the order intake in that and the deals that we closed in Q1 and so on. And we, obviously, will continue to monitor this going forward.

Again, the on-premise is following the same trend if you'll compare it annually. There is a segment of customers, as Juhani also mentioned, that still prefers the on-premise solution versus the cloud solutions.

Then if you look at the cybersecurity consulting, as I said taking into account the divestments, which is not in our official numbers taken out. The divestment portion on an annual level was about €7 million of revenue that we lost with the divestments from last year on a comparable basis. We reduced about 13%, and that was due to continued high attrition and so on. But I said also, we have a number of new consultants on board already and it takes a while to get them operational and so on. So we do expect in the second half the situation to improve.

Here's the traditional deferred revenue, very similar to previous quarters, so I guess I'm not going to spend too much time on that. So there is still a large chunk of our deals that sits in our balance sheet as well and will be recognized as time goes by.

Then, this is obviously the last quarter and that we are still bound by the IFRS 5 standard and have to obey to those rules. So it's not exactly how we look at it operatively. So, here, you can see a reconciliation on that. And as said, we estimate our comparable EBITDA to be about minus 8% in second quarter, which was as we also expected and we're thinking about this quarter in beforehand.

Then if you look at the full P&L, very much the same numbers that I just went through. If you look at the revenue number, though, I said it's on our books is 2% growth. But if you look at it on a comparable basis, meaning taking out the divestments, then Q2 was about 7% and year-to-date we're about 9% at the moment and so on. So, just to be clear on that and so on.

And then lastly, just a word as Juhani mentioned, just for those who hasn't followed us that much. So, just to understand that in terms – part of the demerger based on IFRS rules, we have to also post both the gain in this case when we demerged the consumer business through our P&L, and therefore you see the €459 million gain in our total official P&L from the discontinued operations. There's a few other items as well so net is €459.2 million, but just to clarify that portion of our P&L for those who are maybe not familiar with our numbers so far.

And we stick with our guidance that we have given out in the CMD and so on. So, our guidance continues to be that our revenue from cloud native products will grow approximately 30% from previous year and also we expect this to accelerate in the second half, and the comparable revenue will be growing on a full-year basis on a low double-digit level from the previous year.

And the estimated comparable EBITDA will be decreasing from last year, but we do expect that to improve as we go forward in this year and the second half to be better than the first half. And then we also remain the same with our medium financial targets that we issued earlier in the year.

So with that, a very quick run through the numbers, and I think at the moment, I would maybe invite Juhani back here and then we would be ready to take Q&As in the room maybe first and then online, or how did you think, Laura, we would go by?

QUESTION AND ANSWER SECTION

Laura Viita

Investor Relations Director, Laura Viita

A

Yes. We'll go first for the questions in the room. So who wants to start? Matti was there first.

Matti Riikonen

Analyst, Carnegie Investment Bank AB (Finland)

Q

Hi. Good afternoon. It's Matti Riikonen, Carnegie. Couple of questions, maybe go into the products first. You already mentioned that the – you saw EDR and MDR growing nicely. You didn't talk about EPP. So, how is that portfolio behaving in your total offering? Is it still growing? And what kind of growth differences are we talking about between these kind of product areas?

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

So, yes, we have seen actually some of the demand for EPP migrating to become demand for EDR. Basically, customers are then kind of moving with the technology because I think EDR, of course, is providing many capabilities that today are required that weren't required several years ago, and that's a natural progression in that sense. Then I think that, of course, pure EPP, the whole on-premise base is EPP and that, of course, has its own dynamic, but that will always remain an EPP. By the nature of it, it's on-premise as such. I wouldn't say there's anything dramatic. Rather, I would say that it's a more of a natural progression where some customers are moving from EPP.

Tom, anything you want to comment on that?

Thomas Jansson

Chief Financial Officer, WithSecure Corp.

A

No, I think EPP will continue to be a very important part of our portfolio also going forward. So, as Juhani said, we don't see any dramatic moves anywhere, but EDR clearly has a good market demand at the moment.

Matti Riikonen

Analyst, Carnegie Investment Bank AB (Finland)

Q

So, did I understand correctly that were you saying that EPP is still growing year-over-year basis if you combine the on-prem and cloud sales?

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

I don't think we've given a breakdown on EPP and EDR before. But overall, I would say that the entire portfolio is growing and doing well.

Matti Riikonen

Analyst, Carnegie Investment Bank AB (Finland)

Q

And did you mean that the customers would be kind of replacing EPP altogether, so taking only EDR? Did I understand...

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

So, in some cases, of course, there's some kind of an upgrade path for those customers that have been in the EPP that we are supporting. But I would say that some of the demand for that used to be only for EPP is being replaced by being in demand now for EDR.

Matti Riikonen

Analyst, Carnegie Investment Bank AB (Finland)

Q

Okay. Can you comment anything about the growth rates in the newer areas like EDR and MDR?

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

So, EDR and MDR are part of our cloud solutions portfolio. So, we are – at the moment, we are only giving the growth figure for the total portfolio that you saw.

Matti Riikonen

Analyst, Carnegie Investment Bank AB (Finland)

Q

Okay. And can we assume that the Salesforce platform services are growing pretty much the same rate as, let's say, MDR and EDR? Are there big differences in those growth rates?

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

I think we – and this is more about maybe our material in the Capital Markets Day, but I did – I think if my memory serves me right, we saw some index growth rates for the different businesses and they were materially different also inside there. So, there is a fairly high growth percentage for cloud protection content and that, of course, has continued.

Matti Riikonen

Analyst, Carnegie Investment Bank AB (Finland)

Q

Right. And maybe finally of this topic, when do you think that that Salesforce platform services would contribute kind of a meaningful number to your growth rate, so that the basis would be large enough to make a difference in your growth rates? Is it happening already now that it's, let's say, in percentages of your growth of the whole company or...

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

You need to define meaningful, I guess, and...

Matti Riikonen

Analyst, Carnegie Investment Bank AB (Finland)

Q

Let's say meaningful is 5%.

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

I don't know. Tom, do you want to comment on this one?

Thomas Jansson

Chief Financial Officer, WithSecure Corp.

A

Maybe verbally we can comment that part of our medium-term financial targets, we do expect Salesforce solution to be a big contributor to that growth. So, maybe that gives you a time perspective a little bit.

Matti Riikonen

Analyst, Carnegie Investment Bank AB (Finland)

Q

Okay. Yeah, fair enough. I have some technical questions as well, but let's take them a bit later.

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

Okay. Thanks.

Laura Viita

Investor Relations Director, Laura Viita

A

Thanks, Matti. So, I'll pass to Felix.

Felix Henriksson

Analyst, Nordea Bank Abp (Finland)

Q

Hi. Felix Henriksson from Nordea. I have three questions. I can go one by one. Firstly, to Tom perhaps. Related to the gross margin, it was down by around 400 basis points year-on-year, and you were explaining it with sort of higher hosting costs as well as sort of the onboarding of new consultants. So, could you just help us out a bit on how the contraction sort of was divided between these two factors? What's the...

Thomas Jansson

Chief Financial Officer, WithSecure Corp.

A

Yeah. Yeah. Sorry, I forgot to say that in my slides but, yeah, gross margin was a little bit down and there's two components. As you mentioned, there's one that the EDR has a more gross margin cost than EPP, so relatively that had an impact, and then also our new consultants that we have hired who is not operational yet. So those costs we have in our consulting gross margin. So our consulting gross margin was down in Q2 because of that. Obviously, that's then good for the future. But now at this point, the gross margin took a hit until we have them generating also top line.

Felix Henriksson

Analyst, Nordea Bank Abp (Finland)

Q

And was one of those two explaining factors sort of larger than another?

Thomas Jansson

Chief Financial Officer, WithSecure Corp.

A

Probably EDR was slightly bigger but they had a – those were the two that swunged our gross margin.

Felix Henriksson

Analyst, Nordea Bank Abp (Finland)

Q

Cool. And then related to sort of your financial targets, I know you reiterated them. But just thinking of your sort of target of breaking even on an EBITDA level in 2023 and given the sort of current headwinds you're facing with

attrition and salary inflation overall, has this sort of changed your thinking at all around perhaps how to get to that breakeven level?

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

Not really. I think we are kind of still maintaining what we have said about profitability target and there is a path towards that.

Felix Henriksson

Analyst, Nordea Bank Abp (Finland)

Q

Okay. And then perhaps lastly, on the second half of the year and the cloud revenue growth accelerating, could you just help us out a bit on sort of what gives you confidence on guiding accelerating cloud revenue growth there? Is it sort of based on the current pipeline you're seeing or recently signed deals or...

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

So, it's a combination of several things. Of course, seasonality plays a role here in our industry as well. So, typically, orders revenue are a little bit more weighted towards H2 that we have seen historically and we believe that to be the case this year as well. And then, of course, we are obviously analyzing the pipeline sales funnel that we have and, of course, that's part of the picture as well.

Felix Henriksson

Analyst, Nordea Bank Abp (Finland)

Q

Thanks. That's all for me.

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

Thanks.

Laura Viita

Investor Relations Director, Laura Viita

A

Thanks, Felix. I'm passing to Atte here.

Atte Riikola

Analyst, Inderes Oyj (Research Firm)

Q

Hi. It's Atte Riikola from Inderes. Maybe one question about gross margin thing. You said that the growth in EDR affected your gross margin, but I think when we watched your Capital Markets Day slides, your gross margin ambition for the EDR is much higher than your current gross margin. So, should we assume that the EDR's gross margins are now way, way below the target level? And where is like the improvement coming in the coming years?

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

So, let's be clear that EDR is a pure software product. And theoretically, of course, if you are delivering software product on-premise, the gross margin is 100%, and anything that you take down from there is related to the delivery cost. Now, in the case of on-premise, there is no delivery cost that we see in our books. But when it's

about EDR, that solutions runs on public cloud infrastructure and the delta between the two, i.e., the delivery costs, is purely related to the public cloud costs, the hosting costs that we pay. So in that sense, it's not really performance related, it's just the structure of the business.

Atte Riikola

Analyst, Inderes Oyj (Research Firm)

Q

All right. And then you said that net revenue retention is important KPI for you. So, could you share us what it was on Q2?

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

Yeah. I think we expect to be able to share more about that going forward as we stabilize the collection of the data and that metric a little bit later down the road, but we will, I think – I don't know if we want to put a date on that one, but we will hopefully share that in the future.

Thomas Jansson

Chief Financial Officer, WithSecure Corp.

A

Yeah, we gave you an indication in the CMD and we expect to start sharing that on a regular basis also going forward.

Atte Riikola

Analyst, Inderes Oyj (Research Firm)

Q

All right. And then, maybe one question about consulting. So, the attrition is really high right now, but where are all those people going? Are they just changing places between different consulting firms or like going in-house?

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

I mean, globally speaking, there is a mismatch between supply and demand in terms of cybersecurity consultants. Consulting is the largest segment in the overall cybersecurity market. Services market is the biggest chunk, and it's just a question of this mismatch.

And, of course, people are going to other cybersecurity companies. Sometimes, they are joining, very often, smaller outfits than what we are that don't necessarily have the other things that we can offer like global presence, career progression, development opportunities. So then, they typically offer much more in terms of salary. Of course, from the employer's perspective, there's also sometimes a higher risk, and this is what we are seeing happening in those areas where we operate. Other companies are facing that, too.

Just looking at the numbers, we seem to be below still what the industry average is, and we're quite confident that this will now improve towards the latter part of Q3 because we have been quite successful in recruitment. Unfortunately, that is visible also in Q2 in terms of the gross margin, and then, the top-line impact because these people haven't become billable yet.

Typically, there is a time lag for a senior consultant. It's about one month onboarding time; for more junior consultants, about three months that we are experiencing. But as said, we expect this to improve.

Atte Riikola

Analyst, Inderes Oyj (Research Firm)

All right. Thank you.

Q

Laura Viita

Investor Relations Director, Laura Viita

Thanks, Atte. So I'm passing this to Veikko next.

A

Veikkopekka Silvasti

Analyst, Danske Bank A/S (Finland)

Thank you. So, Veikko Silvasti from Danske Bank. Continuing on the gross margin issue that we've had few questions already, so I think this was the most concerning thing about the report. So, quite large decrease in gross margin, regardless that your sales mix shifted heavily from consulting towards software. And at least as far as I've understood, in order for you to reach your 2025 targets, your gross margin should probably increase by almost 10 percentage points from the level of 2021. So, just to be clear, is there something extraordinary high cost in the hosting or other gross margin components of the EDR that you've been selling? And how are you going to improve the gross margin of your cloud-based portfolio?

Q

Thomas Jansson

Chief Financial Officer, WithSecure Corp.

So, if I can start. So, we don't see an issue in the gross margin. We see the mix change that we have been communicating. And I think there's two components that you need to think about. There will be an improvement in actual gross margin products as they scale and so on. And as we scale, we expect that to improve as well. So, I think you need to think in that way, both in terms of scaling effect, but also improving the actual gross margin.

A

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

And I would hasten to add that the actual – the Elements portfolio is not impacted by this. I think the only impact is the delivery mechanism for EDR which has hosting costs that take the gross margin down a little bit. But, of course, we expect that to be compensated by better profitability when you look at the EBITDA impact of that one. So, the areas where the gross margin has more variance are MDR and then consulting in our total business mix.

A

In the MDR, it is a question of the solution itself, which is a combination of the software, which is largely our EDR plus some other modules of our software portfolio, and then the people cost, the threat hunters that are using that technology at our customer premises.

And now we have been actually improving our gross margin now during Q2 in terms of the MDR gross margin. So, we have improved the productivity of our threat hunters, i.e., how many sensors they are able to handle, and then also the underlying technology and its related costs. So, that's actually moving to a positive direction.

And then, finally, the consulting. As said, we're primarily impacted by the fact that we have had non-billable cost in consulting and that has taken down the overall gross margin.

Veikkopekka Silvasti

Analyst, Danske Bank A/S (Finland)

Okay. So, we can deduct that the hyperscalers are not increasing their hosting costs for you?

Q

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

Yes, I think you can assume that we have fairly competitive rates. We are a good customer of hyperscalers, and we enjoy good relationship in terms of our pricing as well.

Veikkopekka Silvasti

Analyst, Danske Bank A/S (Finland)

Q

Clear. And then I talked with F-Secure, and they also had some problems with their gross margin. So, that was the basis of their miss on profitability, and they stated that they've lost some synergies that they had early on when they were with you. So, have you seen this as well? So, now, obviously, the business you give for hyperscalers is so much smaller than the around €100 million revenue annually from [ph] F-Secure's away (00:31:32). So, have you basically lowered or have they increased the costs compared to, let's say, 2021?

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

We can't comment F-Secure anymore, as you can probably understand. But on the WithSecure side, we have not seen any cost increase because of this.

Veikkopekka Silvasti

Analyst, Danske Bank A/S (Finland)

Q

Okay. Clear. Well, then moving on to consulting, do you think you're able to reach growth then maybe on Q4 on a constant – sorry, on comparable basis in the consulting unit, or do you think that the churn that we've been seeing will continue all the way through the rest of the year?

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

So, without giving any specific numbers, our current recruitment plans and executional targeting for growth also in consulting.

Veikkopekka Silvasti

Analyst, Danske Bank A/S (Finland)

Q

Okay. Final question on consulting is that has there been considerable wage inflation then?

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

It is a factor, I would say, in that whole landscape, and I would also include the rest of the company that the cybersecurity industries where there is this mismatch of supply and demand. And that is reflected also in terms of the salaries increases. Most of the examples are more anecdotal than across the board, though.

Veikkopekka Silvasti

Analyst, Danske Bank A/S (Finland)

Q

Okay. And finally then, on the marketing competitive landscape, have you seen any changes in the main market of Europe regarding competition?

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

Well, European companies have become more popular as opposed to Russian companies, for example. That is a clearly – a big change that has happened in Europe in Q2.

Veikkopekka Silvasti

Analyst, Danske Bank A/S (Finland)

Q

Okay. That's all. Thanks.

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

Thank you.

Laura Viita

Investor Relations Director, Laura Viita

A

Thanks, Veikko. I'll take a couple of questions from the line. First of all, there's our new analyst, [ph] David (00:33:31), asking actually a couple of questions, so I'll take them one by one. So, there's first a question on the gross margin, which I think we've extensively answered already, so I'll hop over. And if you have anything else about that, just please send us another message. Should we expect a return to growing in the low double digits organically in consulting in second half as your new hires ramp up?

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

So, I don't think we are giving specific guidance or changing any of the guidance statements that we have put out forward. But I would just kind of go back to my earlier statement that we are targeting growth also in consulting in terms of our recruitment plans that take into consideration also the attrition levels.

Laura Viita

Investor Relations Director, Laura Viita

A

Good. And then the third one, considering the first half of the year, how confident are you in being able to reach the low double-digit organic growth that you have guided on?

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

Currently, that is our thinking and our aim.

Laura Viita

Investor Relations Director, Laura Viita

A

Very good. Then I'm moving on to our other analyst, Jaakko, who's also online today. Also, question number one is about the gross margin. That's a very popular topic, so I hope we have answered that already. And Jaakko sent me another message if we missed something.

Second question, are you satisfied with the quarterly ARR growth given the increased sales and marketing costs? And second part of this question, how should we expect the LTV-to-CAC ratio develop going forward?

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

Yes. I don't think we give particular targets for ARR in our reporting and communication. As we can see, it has developed favorably and we are on our way of becoming clearly a SaaS company. That's what we can gather from those numbers.

But maybe a kind of a soft promise for the future that we would talk more about this important SaaS metrics going forward, and they include lifetime customer value and customer acquisition costs. Those are important metrics. We track them internally as part of our KPI set. And, of course, our target is to decrease the acquisition cost and increase the lifetime value, which primarily is driven by managing the churn that we're seeing in the customer base.

Laura Viita

Investor Relations Director, Laura Viita

A

Very good. And being in the finance team, I can confirm that those are the hottest questions that we are currently trying to solve.

Then there's a third one on consulting, given the strong market demand and competition for consultants, are you able to hike prices to offset the situation?

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

So, we are typically positioned as a consulting organization that tackles the most complex, most difficult problems there are, and our customer base is representative of that. They are typically companies that are under constant attack. Some of them also face a lot of regulatory requirements in terms of their capabilities in cybersecurity and end result, of course, being that that is reflected in our pricing favorably. And also historically, that has been the profile.

We are a highly technical consultancy. We're not a strategic consultancy. So, we are really known for that and, of course, some of those skills are scarce even in this big landscape, big industry, and we're able to price them accordingly, yes.

Laura Viita

Investor Relations Director, Laura Viita

A

Good. Thanks. Then, another question from the webcast audience. Which companies are direct competitors to WithSecure and what are WithSecure's competitive advantages compared to these companies?

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

So without going into company names or specifics, I think this, as you may know, is a crowded market. There are lots of companies, big and small, that we see, all sizes addressing with different propositions.

I think our primary competitive advantages are related to, first of all, our track record, reputation and history. We have about 30 years behind our belt. We are one of the pioneers in this industry. We are the largest cybersecurity company in the Nordics. And a lot of that, I think, is important when our customers consider their buying decisions.

Then I think we can demonstrate that over 15 years, we've been investing in new technologies like machine learning and AI. Those are hot topics for some companies. But for us, they're business as usual today. And there's been always a clear, strong focus on basing our services solutions products in strong technology research that we have been doing.

And then I would say that our customers, when we ask them, they see us really as their partners. So we really look at the way we work with them. We look at the outcomes that they are getting and that is very much driving our strategy and go to market. And all of this combined are, of course, we believe, giving us a distinct advantage over many others.

Laura Viita

Investor Relations Director, Laura Viita

A

Very good. And maybe I can add on that. So in our Capital Markets Day of the 3rd of June, there's actually a matrix about the competition because we do get a lot of questions on that. So, we try to clarify it there.

A follow-up question from Jaakko, our analyst, follow-up on consulting. Could you give any profitability indication for the business? And this is consulting business. Are you above breakeven in EBIT?

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

Unfortunately, we can't disclose anything beyond what we have disclosed so far.

Laura Viita

Investor Relations Director, Laura Viita

A

Okay. So, Matti, you said you had some technical questions, so passing back to you.

Matti Riikonen

Analyst, Carnegie Investment Bank AB (Finland)

Q

Yes. Hi. It's Matti Riikonen, Carnegie. We touched lightly on the topic of net retention rate and I just want to clarify, where do you measure that? Is it that – does it apply to the software part in on-prem and cloud both, or is it only a cloud revenue metric?

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

Tom, do you want to take that?

Thomas Jansson

Chief Financial Officer, WithSecure Corp.

A

It's on the cloud.

Matti Riikonen

Analyst, Carnegie Investment Bank AB (Finland)

Q

Okay. Then how would you describe the relationship between cloud and on-prem revenue? So, if we assume that or we see from the numbers that the on-prem revenue is declining, but how much of that decline is actually converting to cloud? So, is there a kind of any clear relationship between those and how much then cloud would be without the on-premise contribution?

Thomas Jansson

Chief Financial Officer, WithSecure Corp.

A

So, if I start and Juhani maybe continue, but I think it's clear that there's an element of migration from on-premise to cloud, but I would still say that the majority of the growth comes from new customers in cloud.

Matti Riikonen

Analyst, Carnegie Investment Bank AB (Finland)

Q

Yeah. So, that's what you have been earlier saying?

Thomas Jansson

Chief Financial Officer, WithSecure Corp.

A

Yes. And that still holds.

Matti Riikonen

Analyst, Carnegie Investment Bank AB (Finland)

Q

Over 50% of the cloud growth is actually new customers bringing that.

Thomas Jansson

Chief Financial Officer, WithSecure Corp.

A

Yeah. We haven't given exact numbers, but verbally this is...

Matti Riikonen

Analyst, Carnegie Investment Bank AB (Finland)

Q

Well, the majority is over 50%. Okay. And then I think you mentioned already the ARR calculation, but could you please remind me at least how you do it?

Thomas Jansson

Chief Financial Officer, WithSecure Corp.

A

It's the MRR, meaning the monthly recurring revenue times 12 at the end of the period.

Matti Riikonen

Analyst, Carnegie Investment Bank AB (Finland)

Q

So, it's the last month of the quarter...

Thomas Jansson

Chief Financial Officer, WithSecure Corp.

A

Yes.

Matti Riikonen

Analyst, Carnegie Investment Bank AB (Finland)

Q

...times 12.

Thomas Jansson

Chief Financial Officer, WithSecure Corp.

A

Yes.

Matti Riikonen

Analyst, Carnegie Investment Bank AB (Finland)

Q

So, we basically can't use your numbers to think that, okay, it's kind of tracking somehow the history. It's just the latest kind of factor.

Thomas Jansson

Chief Financial Officer, WithSecure Corp.

A

Well, it's an indication of what the revenue will be over the next 12 months.

Matti Riikonen

Analyst, Carnegie Investment Bank AB (Finland)

Q

Yeah. But, of course, without knowing whether the last month was the best month or – and what it has been seasonally and it is quite a volatile metric.

Thomas Jansson

Chief Financial Officer, WithSecure Corp.

A

Well, ARR usually is a monthly that...

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

Yeah.

Thomas Jansson

Chief Financial Officer, WithSecure Corp.

A

...continues for a month – month-by-month. So, the growth is new business usually.

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

And the nature of the business is that's actually relatively stable. So, we make these long-term commitments. Customers usually consider them carefully. So, it doesn't actually fluctuate that much. I think the main driver there is usually churn, which we don't report yet. Hopefully, we'll be able to come back to that at some point in the future. That, of course, is then a discussion about, okay, have we lost customers and why? And that would be – I would say that, overall, it's developing favorably.

There are some of these platform changes that are happening, not just jumping from EPP into cloud, but also we have previously had – inside MDR, we've had an old and new platform. Now the majority of the customers have been migrated to the new Countercept and the new underlying technology. But in the process, of course, there has been also some churn, some of it almost intentional because I think some of those customers have been very, very small and not very much suited to the larger, more enterprise-oriented solution that we have come across.

Matti Riikonen

Analyst, Carnegie Investment Bank AB (Finland)

Q

All right. Thank you. Maybe then, finally, when the EPP customers decide to leave, where do they go and what do they buy instead?

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

Well, there are, of course, some vendors in the landscape that are providing on-premise. And, of course, we haven't stopped providing. And our development focus is elsewhere because we see that the cloud solutions portfolio provides us with the right growth opportunities, but then there are other companies who may think differently.

And in our case, of course, in some cases, these are governmental customers so there are very long commitments in terms of supporting them and we, of course, have undertaken those commitments and we continue to support. In some cases, of course, there has been an implication in pricing so that we are also asking for more money in order to do that.

Matti Riikonen

Analyst, Carnegie Investment Bank AB (Finland)

Q

All right. And then you said that NRR is not calculating from on-premise customers. But those ones who convert to cloud, do they pay more than they did before?

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

Typically, the solution is much broader. So, the answer is yes. And that, of course, means that some of them will also churn.

Matti Riikonen

Analyst, Carnegie Investment Bank AB (Finland)

Q

All right. Thank you. That's it from me.

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

Thank you.

Laura Viita

Investor Relations Director, Laura Viita

A

Thanks. Any more questions from the room? Seems our webcast has gone silent.

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

And it's great to have some new analysts following us online, so thanks for being there. So, hopefully, you'll join us in the future as well. If there are no other questions...

Laura Viita

Investor Relations Director, Laura Viita

A

Hey, one more.

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

Yes.

Laura Viita

Investor Relations Director, Laura Viita

A

Sorry. Okay. So, we have seen your R&D spend increase as a share of revenue in Q2 compared to Q1. Could you detail what drove this trend and how we should think about it for the rest of the year?

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

I think in general, of course, we are also taking our portfolio forward across the board. I think the common denominator is cloud, and we are seeing certain areas where we need to increase some of our investments in order to capture that opportunity, and that's reflected in the R&D numbers.

Laura Viita

Investor Relations Director, Laura Viita

A

And what about the second part? Do you see it continue or is it of one-off nature?

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

A

So, we see that we will continue moderately cautiously investing, but we had taken this into account when we have announced our financial targets.

Laura Viita

Investor Relations Director, Laura Viita

Very good. If no more questions, I think we're ready to finish.

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

All right. Thank you very much for participating.

Thomas Jansson

Chief Financial Officer, WithSecure Corp.

Thank you all.

Juhani Hintikka

President & Chief Executive Officer, WithSecure Corp.

Thank you, everybody in the room.

Thomas Jansson

Chief Financial Officer, WithSecure Corp.

Thank you.

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