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PRESENTATION

Operator

Greetings, and welcome to Tenable's Second Quarter 2021 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

I would now like to turn this conference over to your host, Ms. Erin Karney, Senior Director of Investor Relations. Thank you. Ma'am, you may begin your presentation.

Erin Karney - *Tenable Holdings, Inc. - Senior Director of IR*

Thank you, operator, and thank you all for joining us on today's conference call to discuss Tenable's second quarter 2021 financial results. With me on today's call are Amit Yoran, Tenable's Chief Executive Officer; and Steve Vintz, Chief Financial Officer.

Prior to this call, we issued a press release announcing our financial results for the quarter. You can find the press release on the IR website at tenable.com.

Before we begin, let me remind you that we will make forward-looking statements during the course of this call, including statements relating to Tenable's guidance and expectations for the third quarter and full year 2021, growth and drivers in Tenable's business, changes in the threat landscape and in the security industry and our competitive position in the market, growth in our customer demand for and adoption of our solutions, planned innovation and new products and services, Tenable's expectations regarding long-term profitability and the impact of COVID-19 on our business and on the global economy. These forward-looking statements involve risks and uncertainties, some of which are beyond our control, which could cause actual results to differ materially from those anticipated by these statements. You should not rely upon forward-looking statements as a prediction of future events.

Forward-looking statements represent our management's beliefs and assumptions only as of today and should not be considered representative of our views as of any subsequent date. We disclaim any obligation to update any forward-looking statements or outlook. For further discussion of the material risks and other important factors that could affect our actual results, please refer to those contained in our most recent quarterly report on Form 10-Q and subsequent reports that we file with the SEC, which are available on the SEC website at sec.gov.

In addition, during today's call, we will discuss non-GAAP financial measures. These non-GAAP financial measures are in addition to and not a substitute for or superior to, measures of financial performance prepared in accordance with GAAP. There are a number of limitations related to the use of these non-GAAP financial measures versus their closest GAAP equivalents. Our earnings release that we issued today includes GAAP to non-GAAP reconciliations for these measures and is also available on the Investor Relations section of our website.

I'll now turn the call over to Amit.

Amit Yoran - *Tenable Holdings, Inc. - President, CEO & Chairman*

Thank you, Erin, and thank you all for joining us today. Today, I'll highlight our strong Q2 results and continued leadership in the market, the traction we're seeing in cross-sell and how our differentiated approach to Cyber Exposure is successfully addressing a critical need in the market.

With that, let me first touch on our Q2 results. We've continued to build on the strong momentum in Q1 as reflected in our impressive Q2 results. Our calculated current billings accelerated growth to 23% year-over-year, driven in part by a shift to cloud, growing cross-sell opportunities and persisting threats and cyber incidents across IT and OT environments. We also had strong cash flow in the quarter, saw an expansion of our non-GAAP operating margin and had a $0.04 beat in EPS from the high end of our guided range. Finally, in July, we entered into a credit agreement consisting of $375 million secured term loan and $50 million secured revolving credit facility, take advantage of historically low interest rates and bolster our balance sheet to support growth. Steve will discuss the quarter in greater detail, but we're incredibly excited about where we are and our ability to fuel the business going forward.

We're seeing an increased focus on cyber security across all areas including the presidential executive orders, congressional attention, focus from private industry and corporate leadership and Boards of directors, increased security budgets and desired understand cyber risk of being driven by high profile cyber incidents and business impacting outages. The importance placed on prevention and risk management has never been more prominent.

The holistic strategic VM program is fundamental to proper risk management. The prominence of VM continues to drive growth opportunities for Tenable. We are very optimistic about what we are seeing in the core VM market. We continue to see good greenfield opportunities as surprisingly, many large enterprises still do not have a formal VM program. In addition, we believe that attacks like those against Microsoft and Colonial Pipeline continue to elevate discussions about risk at the Board level and drive the adoption of our Cyber Exposure solutions.

We saw a strong growth in our core VM offerings in the quarter, particularly of our cloud platform, Tenable.io. Our pipeline remains healthy as customers grapple with how to get continuous visibility into their assets and understand their exposure to emerging threats.

Our competitive differentiation continues to strengthen as we execute on our best-of-breed strategy. We continue to see very strong win rates. We believe our technology is considered more accurate and covers a broader set of asset types with more insightful analytics and reporting. For example, according to third-party and company research, we have more than 20-plus percent greater coverage of CVEs than our competitors and test our products to six-sigma accuracy. We believe our technology leadership and best-of-breed focus is one of many reasons why we continue to drive market share gains and competitive differentiation.

A great example of this is a 7-figure win in the quarter that's a reflection of the market desire for differentiated technologies. A large government agency was looking to expand their asset coverage as well as meet continually evolving internal compliance policies and regulatory requirements.

By combining our passive sensing and active scanning we can continuously identify new assets coming online and monitor the network for a variety of sensitive security-related information.

Our strategy has been to leverage our foundational understanding and expertise of VM and expand around tightly aligned use cases. Equally as important to our core portfolio is the ability to scale our solutions as digital transformation continues to broaden the attack surface. This holistic Cyber Exposure approach is resonating with customers, as is the continuous dynamic assessment of assets and user permissions along with the means to prioritize remediation based on risk, which has never been more important than it is today.

We saw continued strength across all our cross-sell motions, including EP, OT and particularly around the growing opportunity with AD. Starting with our cloud offerings, we continue to help our customers secure their cloud environments. This remains an area of focus for our business as it's increasingly important to our customers. IO has grown faster than SC for several quarters in a row which we expect to continue to be a common theme. We saw continued traction with frictionless assessment, and we're excited about the long-term outlook for enabling customers to assess assets across public cloud environments without the need to perform active scans or install agents.

EP continues to see strong traction, which we think validates the importance of our holistic approach. A great example of the benefit of EP is Ontario Health, where they had multiple unique solutions across a number of acquired organization. They chose Tenable.ep to standardize and provide complete coverage across all of their entities.

Another area of importance for Tenable is operational technology or industrial control systems. As assets and utilities, manufacturing and data centers come online, the convergence between OT and IT is accelerating. While these environments are extremely complex, understanding these hybrid environments has become a priority, given recent examples of high visibility breaches and corresponding outages. The sales cycles can be more lengthy, however, early deployments have been successful and we see expanded business opportunities as customers deploy in a more programmatic fashion across their global facilities.

In the quarter, we had a great 6-figure cross-sell win with a large public utility provider looking to gain visibility into their entire attack surface. Their positive experience as a current Tenable customer and trust in the Tenable partnership helps give them the confidence that Tenable.ot will meet their needs.

Finally, while we're still in the early stages with Tenable.ad, the important role this product plays in identifying risk cannot be overstated. Microsoft Active Directory is incredibly complex and exceedingly susceptible to compromise, making it one of the most targeted assets within an enterprise. The vast majority of ransomware attacks go after Active Directory, including many recent high-profile breaches and headlines. Tenable.ad provides insights into the weaknesses of and active attacks against Active Directory deployments and identifies misconfigurations, making it foundational to securing card workloads, securing remote work and adopting zero trust architectures. We're seeing very strong early traction of our solution and an excited pace of pipeline creation.

An example of this is a large transportation and logistics company that is an existing Tenable.io customer. Given our track record with IO and their need to increase their visibility into misconfigurations, they looked into Tenable to help them secure their AD environment.

This is a reflection of our strong reputation in the size of the Active Directory security opportunity, which remains almost entirely unaddressed. We're aggressively growing pipeline across both Tenable customers and other organizations, noting, however, that we expect Tenable.ad sales to play out along longer enterprise sales cycles. Our platform provides a holistic view of cyber risk across the various technologies and compute environments that now make up the corporate attack surface. This enables customers to continuously and confidently manage cyber risk based on business risk.

Helping organizations answer fundamental questions such as how exposed am I, how at risk am I and what should I be doing about it continue to drive our focus and investment. In answering those key questions, enterprises have to grapple with everything from policy and compliance to early detection of vulnerabilities, to securing their cloud infrastructure. By leveraging our core strengths, we have earned the trust of our customers to broaden our product set and help them solve for increased risk associated with digital transformation. Our vast experience and broad platform allow us to integrate tremendous amounts of data in 1 place to holistically assess cyber risk. Our long history in vulnerability management, combined with this vast data set and experience in managing risk differentiates us from our competitors.

Against the backdrop of persistent threats and systems outages causing business disruption, enterprises today are not looking for good enough security solutions. Decades of companies trying to launch subpar platforms are, in part, responsible for the catastrophic situation that is security today. We believe enterprises are looking for best-in-class independent audit capabilities, which can tightly integrate with the security enterprise infrastructure investments, which they've already made. Leveraging a best-of-breed platform to perform this independent audit of security can achieve the required checks and balances that enterprises are looking for. We're starting off to a great start in the first half of the year and are excited about our outlook.

Foundational drivers like ship to cloud and zero trust, combined with ransomware and high-profile breaches, have increased budget and prioritization of cyber security and cyber risk management. In summary, we're very pleased with our Q2 results, and we believe they reflect continued momentum across all areas of our business. which fuels our enthusiasm for the long term.

I will now turn the call over to Steve.

Stephen A. Vintz - *Tenable Holdings, Inc. - CFO*

Thanks, Amit. As Amit mentioned earlier, we're very pleased with our results for the second quarter, highlighted by an acceleration in top line growth due to strong cloud adoption and a sizable increase in the number of large deals, and on the bottom line, we're very pleased with the substantial beat in non-GAAP EPS and strong free cash flow. We also recently completed a debt issuance in July, which bolsters our balance sheet and provides us with the added flexibility to continue to invest in growth. I will discuss the impact of our $425 million term loan B and revolver in greater detail during my remarks about our outlook for the year.

Please note that all financial results we will discuss today are on a non-GAAP financial measure basis with the exception of revenue. As Erin mentioned at the start of this call, GAAP to non-GAAP reconciliations may be found in our earnings release issued earlier today, which is posted on our website.

Now on to our results for the quarter. Revenue for the quarter was $130.3 million, which represents 22% year-over-year growth. Revenue in the quarter exceeded the midpoint of our guided range by approximately $5 million. Visibility remains high as a percentage of our recurring revenue is 94%, which is primarily a result of our annual prepaid subscription model. In terms of the trend line, we saw a sequential uptick in revenue for the quarter, notwithstanding the contribution from Alsid, which is a very important milestone for Tenable. Revenue in the quarter was aided by strong demand for both new and renewal business.

In terms of new business, excluding the customers added from the Alsid acquisition, we added 399 new enterprise platform customers, which is up from the 341 we added in Q2 of 2020. While we are consistently adding hundreds of new enterprise customers each quarter, equally impressive is the momentum with large deals. We added 67 net new 6-figure customers in the quarter, including Alsid customers, which is up from the 29 in the prior quarter and 50 in the same period last year. Large deals grew 30% year-over-year as organizations are increasingly turning to us to secure a wider range of network-connected device types and associated user permissions.

Demand was broad-based, but our momentum in the U.S. public sector is certainly of note as we closed over a dozen 6-figure deals in the quarter across civilian and defense agencies as a result of a better spending environment. We also saw continued outperformance in the mid-market, where we believe the appeal of our risk-based platform has been heightened by the recent threat landscape.

In terms of renewal business, we saw continued expansion in our net dollar renewal rate, aided by both strong renewal rates and the cross-sell of additional modules as customers seek to understand a broader view of their cyber exposure. Our strong results are also reflected in our calculated current billings. CCB, defined as the change in current deferred revenue plus revenue recognized in the quarter, grew 23% year-over-year to $136.8 million, which is better than expected. While our Alsid acquisition closed only recently in late April, the addition of our identity and user permission vulnerability assessment to our cyber exposure platform was well received by our customers and prospects, leading to outperformance of our early expectations for the business, although the revenue and CCB contributions for the quarter were modest given deal timing and sales cycles.

I'll now turn to operating expenses, which include incremental investments in 2 months of Alsid costs, offset in part by continued efficiencies in our business. I'll start with gross margin, which was 82% this quarter and 83% last quarter. As discussed during our last call, our gross margin reflects increased investment in our public cloud infrastructure that support a broader set of predictive analytics and a more expansive data lake. Looking ahead, we expect gross margins to remain at current levels in the second half of the year despite incremental cloud investments and the impact from Alsid.

Sales and marketing expense for the quarter was $58.1 million, which is up notably from the $52.3 million last quarter. Sales and marketing increased sequentially, primarily due to an increased headcount-related cost, including Alsid, as well as an increased number of quota-carrying sales reps. In addition, there was incremental investment in demand generation activities. All of this reflects a continued trend of higher sequential quarterly spend in response to a better macro and stronger demand environment for our cyber exposure solutions. Sales and marketing expense as a percentage of revenue was 45% compared to 42% last quarter. Given our performance in the first half of the year and increasing confidence in our business, we will continue to invest in sales and marketing in the second half of the year.

R&D expense for the quarter was $23 million, which is up from $22.7 million last quarter. The change reflects the incremental engineering resources related to the Alsid acquisition, partially offset by lower payroll taxes due to FICO limits and lower PTO accrual. As a percentage of revenue, R&D expense was consistent with last quarter at 18%. Given our best of breed approach, innovation remains a top priority, and we plan to continue to invest throughout the year.

G&A expense was $13.8 million compared to $13.7 million last quarter. As a percentage of revenue, G&A expense was 11% this quarter, which is flat compared to last quarter. We expect to see higher G&A expense in the second half of the year as we return to the office and make investments in infrastructure to support our growth. Income from operations was $11.5 million compared to $13.9 million last quarter. Operating margin was positive 9% for Q2 compared to positive 11% last quarter. As previously discussed, Q2 reflects 2 months of incremental expense from Alsid, which was approximately $3.5 million in total, offset by a de minimis revenue contribution, including the write-down of the acquired deferred revenue. All of this resulted in significant EPS upside in the second quarter as our non-GAAP earnings per share was $0.09, which is $0.045 better than the midpoint of our guided range.

Let's turn to the balance sheet. We finished the quarter with $261 million in cash and short-term investments, reflecting the $98 million of consideration paid in connection with the Alsid acquisition. However, this does not reflect the $360 million of proceeds net of credit or fees from our debt issuance, which closed on July 7. Current deferred revenue at June 30 was $334 million, giving us a lot of visibility into revenue heading into Q3 and the remainder of the year.

Turning to cash flow. We generated $15 million of positive free cash flow in the quarter. This compared quite favorably to free cash flow of $6.6 million in Q2 last year. Over the last 12 months, we've generated $86 million of positive free cash flow. With high recurring revenue, high gross margins and high renewal rates, we feel confident that we can continue to generate attractive levels of free cash flow while continuing to invest in the business.

With the results of the quarter behind us, I'd like to discuss our outlook for the third quarter and full year 2021. Our strong start to the year continues to give us greater confidence in the business environment. With that said, for the third quarter, we currently expect revenue to be in the range of $133 million to $135 million; non-GAAP income from operations to be in the range of $7 million to $8 million; non-GAAP net income to be in the range of $1 million to $3 million, assuming a provision for income taxes of $2.3 million; and non-GAAP diluted earnings per share to be in the range of $0.01 to $0.03, assuming 115 million fully diluted weighted average shares outstanding.

And for the full year, we currently expect calculated current billings to be in the range of $590 million to $595 million; revenue to be in the range of $528 million to $531 million; non-GAAP income from operations to be in the range of $40 million to $44 million; non-GAAP net income to be in the range of $29 million to $33 million, assuming a provision for income taxes of $3.5 million; and non-GAAP diluted earnings per share to be in the range of $0.25 to $0.29, assuming 115 million fully diluted weighted average shares outstanding.

As a matter of clarity, the guidance we are providing today reflects our outperformance in Q2 as well as a notable raise for the year for both CCB and revenue. Also, our EPS guidance for the full year includes $7 million of interest expense equating to $0.06 per share associated with our new credit facility.

In summary, we're pleased with the results for the quarter, which gives us increasing confidence that we remain well positioned to deliver compelling growth and profitability over the long term.

And now I'll turn the call back to Amit for some closing comments.

Amit Yoran - *Tenable Holdings, Inc. - President, CEO & Chairman*

Thanks, Steve. The profile of Cyber Exposure continues to elevate as digital transformation and recent events highlight the importance of cyber security and zero trust. Further, these events have proven that we can't rely on strong perimeter defenses, but need to assess risk across the entire enterprise.

Our message has been very consistent. For Tenable, our core strength in understanding cyber risk has driven our success. It's aided in our natural expansion across the surface of attack, improving the security posture of cloud, OT deployments and now AD. We believe our strengthening platform of capabilities positions us for long-term success as our customers continue to shift to hybrid and cloud environments.

We hope to see many of you virtually for the D.A. Davidson, Piper Sandler and Jefferies conferences in the coming weeks.

We'd now like to open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Brian Essex with Goldman Sachs.

Brian Lee Essex - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

Congrats on the results. I guess, Steve, I was wondering maybe if we could start with the results in the quarter, really nice subscription revenue growth. Could you talk about maybe attach rates, where you're seeing contribution there? And maybe a little bit of insight around perpetual license growth, is that just renewals? And how to think about that going forward?

Stephen A. Vintz - *Tenable Holdings, Inc. - CFO*

Sure, Brian. Thanks for your question. As I commented earlier, we're very pleased with the results of the second quarter as we saw performance in both CCB and revenue. We believe our risk-based platform is resonating with customers. Q2 was strong with regard to demand. We added a lot of new enterprise platform customers, 399 to be exact. We're seeing momentum with larger deals. They're up 30% approximately year-over-year as organizations are increasingly turning to us to secure a wider range of network-connected devices and associated with user permissions. We also talked about momentum in the U.S. public sector here as we closed over a dozen 6-figure deals in the quarter across civilian and defense.

In terms of the attach rates, one thing I will note here is that our newly launched Tenable.ep, which brings together vulnerability management, web application security, Container Security and Lumin into a single offering has been a catalyst of growth here for larger deals and validates our holistic approach to assessing risk. This is just one example of where we're having success, both with attach rates as well as on the expansion side, where we saw continued traction with our net dollar renewal rate.

So I think this quarter, given the growth from the top line demonstrates our ability to see higher attach rates for newly launched products, and we're having success there. And obviously, pleased with the print for the quarter.

Brian Lee Essex - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

Got it. And maybe if I could follow up. In terms of revenue, I guess, growth by geo, how did that play out in the quarter? I mean we had conversations in the quarter that seem to imply that things are much worse in Europe than they are domestically here in the U.S. So I was wondering if you're seeing the same and how you may be positioned in that market relative to where we might have a little bit more visibility in the U.S. with good visibility in the government and what's going on here. But how do geos outside the U.S. look for you?

Amit Yoran - *Tenable Holdings, Inc. - President, CEO & Chairman*

We're very pleased with the results in Europe and specifically, in particular, if you look at EMEA and the Middle East, so we continue to have traction there. We're seeing outperformance, specifically in that theater. And I think one of the reasons why you saw the acceleration of the growth is because we're also seeing acceleration in new business that comes in terms of both new customers as well as upsells from existing customers. So larger deals, traction with Tenable.ep, the ability to have higher attach rates and cross-sell some of the products that we've launched really over the past couple of years has been instrumental there. So pleased with EMEA, pleased with Middle East, in particular. Also seeing good traction domestically here in the U.S. And overall, it was a pretty balanced quarter.

Brian Lee Essex - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

Got it. When I said worse in Europe, I meant threat environment, not your performance. So I just want to make that clear. That's very helpful.

Operator

Our next question comes from the line of Hamza Fodderwala with Morgan Stanley.

Hamza Fodderwala - *Morgan Stanley, Research Division - Equity Analyst*

It really seems like the demand environment is improving even versus sort of recently quarterly trends. Just curious if you could sort of stack rank some of the drivers for us between existing customers kind of expanding their asset coverage, right? I don't know if I caught an exact sort of net dollar retention rate, Steve. And then also that versus new perhaps greenfield opportunities in the mid-market or elsewhere, how would you kind of raise the 2? Is there more net expansion versus net new customer adoption or vice versa? Any color you can give us there?

Stephen A. Vintz - *Tenable Holdings, Inc. - CFO*

Well, in terms of the mid-market, it's approximately 25% of our total sales, which is I think the number that we've disclosed earlier. So we're continuing to see outperformance there, which is the good news. As a reminder, we have a pretty compelling go-to-market model where we have a product in Nessus that has brought adoption and use across the mid as well as the large market. It's ubiquitous, creates a cost effective on-ramp to a larger platform sale. So we saw some really good pull-through in the mid-market and the flywheel of Nessus continues to help us. That comes on the heels of more investment in the sales organization as well, not just in the mid-market, but also the large.

But we're an enterprise software company, so a little more than 50% of our sales comes from large market customers, and that's what's creating the inflection point for us. And I would say in terms of greenfield, every quarter, we survey our largest deals and ask what products and what solutions were they using before. It's still about 1/3 of our largest deals are greenfield opportunities using no enterprise VM program. And so that's remained fairly constant for us.

So I would say a combination of new deals and upsell are probably the biggest catalyst, obviously, with contributions in the mid-market, which continues to do well for us. And I think what's driving all of this is probably digital transformation, the need for assessing risk holistically and just complexity and compute and our ability to assess risks across the entire attack surface, whether it's web applications, cloud infrastructure, operational technology. And I think this is resonating well with customers.

Hamza Fodderwala - *Morgan Stanley, Research Division - Equity Analyst*

Got it. If I could just sneak in a follow-up. It seems like a really strong early traction on the federal side. I mean I was wondering if you could give us maybe a preview of Q3, obviously, that being sort of the federal fiscal year close. How are sort of the pipeline trends looking for Q3?

Amit Yoran - *Tenable Holdings, Inc. - President, CEO & Chairman*

Yes. I think the pipeline for Q3 looks healthy. We've had and continue to have a very strong federal year, perhaps more linear than we've seen in previous periods, and that's sort of evidenced by itself with over a dozen 6-figure deals in the quarter across both civilian and defense. And then obviously, a lot of momentum with the EO calling for key initiatives around visibility and early detection of vulnerabilities, we think that bodes very well for the opportunity for us in federal.

We're also extremely excited about the attention being paid to zero trust initiatives, where NIST has recently selected Tenable as 1 of 18 technologies that they're demoing as part of their zero trust initiative concepts in demos and labs. So we think there's tremendous opportunity for continued growth in federal. We think we're exceptionally well positioned to capitalize on that.

Operator

Our next question comes from the line of Rob Owens with Piper Sandler.

Robbie David Owens - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Great. I guess just to cut to it and given some of your comments, are you actually seeing budgets increase as a result of the environment? Or do you think that this is playing out kind of as you would have expected with a better second half? So are we seeing -- I mean we've seen a lot of these major breaches historically, and I think a few have led to an increase in spending. But I think your prepared comments seemed a little more bullish. So at this point in time, are we seeing wallets open up even more for security and security budgets increase? Or is it more of a typical second half?

Amit Yoran - *Tenable Holdings, Inc. - President, CEO & Chairman*

No, I think the secure -- the budgets in the market has never been hotter or more open to security spend, I think. Executive level awareness from the President, Board of Directors, CEOs, audit and risk committees, cyber is front and center to their thinking. Cyber risk is an integral part of their calculus of risk more broadly. I think that's perhaps in part why we've seen an acceleration in the commercial market for us. And we anticipate that in the enterprise market where there's longer sales cycles, budget is available, resources are available. It's just a matter of going through the prioritization, the timing of transactions and deals and enterprise sales cycle. So I think we remain extremely bullish about the opportunity given the increased awareness, visibility and priority of cyber security more broadly.

Robbie David Owens - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Great. And then second, around your Active Directory solution, how much market education is required here? Does the end customer understand all the vulnerabilities with Active Directory and so it's more of an easy sales cycle? Or is there a lot of education that's still having to happen upfront both the customers and with the channel?

Amit Yoran - *Tenable Holdings, Inc. - President, CEO & Chairman*

Yes. Having been in the enterprise security market for almost 30 years, this is one of the weirdest dynamics to describe that I've ever seen. I think there is incredibly broad awareness that Active Directory is a critical gap in security programs. 80-plus percent of ransomware, specifically targets Active Directory. When you see things like Colonial Pipeline and other breaches causing significant business outages, that translates directly to Active Directory.

And I think most CISOs and most security teams recognize that they have a significant issue with Active Directory. Configuring it properly in any large and complex environment is an incredibly difficult task, and there is an incredible gap or lack of mature capabilities and tools available to them. So you'll see sophisticated organizations turning to a consultant to look at their AD environment and see if it's well configured on some kind of periodic audit basis. And that's just not acceptable. It's not getting the job done.

So our sales team is having great success engaging with customers. They know they have issues, they want -- and they're having a good hit rate getting meetings, getting proof of concepts deployed, having conversations around budget. And again, this is a solution -- an acquisition that went to close midway through last quarter. So it will take time. It is an enterprise sales cycle, but we're extremely excited about our position in the market and the capabilities that we're bringing to the table, with a market that has great need and does not have great alternatives available.

Operator

Our next question comes from the line Sterling Auty with JPMorgan.

Sterling Auty - *JPMorgan Chase & Co, Research Division - Senior Analyst*

So I want to be absolutely clear, the 399 platform customers you added did not include the 91 from Alsid, is that correct?

Amit Yoran - *Tenable Holdings, Inc. - President, CEO & Chairman*

That is correct.

Sterling Auty - *JPMorgan Chase & Co, Research Division - Senior Analyst*

I think that makes it the largest Q2 net adds that you've had since coming public. So I'm kind of curious in terms of how much of that productivity is coming direct versus some of the channel programs that you've had. And any comments that you might have about the durability of those net adds into the back half of the year.

Amit Yoran - *Tenable Holdings, Inc. - President, CEO & Chairman*

Well, I think in short, we're pleased with the results for the quarter. We saw some of our highest achievement rates in many years this quarter, so achievement rates and productivity continues to go higher. It comes on the heels of more investment in sales and marketing. We had a quota capacity in the second half of the year. We plan to continue to add quota capacity in Q2 and expect to continue to add quota passing the second half of the year. So we're certainly making the kinds of investments that we think are necessary to sustain attractive long-term growth. We feel really good about our business.

So given the fact that productivity levels are high, achievement rates are high, we're adding sales capacity, given the backdrop of a heightened threat environment, we feel really good about the business. But yes, it's one of our strongest quarters. And what's underpinning that, we called out earlier, but a few things. One, we continue to see strength in the public sector. And I think some of the investments in product are also happening where we're seeing higher attach rates, and we're seeing the expansion rates increase as well, and Tenable.ep is certainly playing a role of that.

And then we're hard at work on building pipeline opportunities. We have more 6-figure deals in our pipeline now than perhaps any time during our history. So look, we're pleased with our ability to add new customers. We think it speaks to the growing demand and importance of VM and the customer's ability to assess all risk holistically, and we're excited about the second half of the year.

Operator

Our next question comes from the line of Saket Kalia with Barclays.

Saket Kalia - *Barclays Bank PLC, Research Division - Senior Analyst*

Maybe for you, Amit, one thing we didn't talk about is capital allocation. I'm kind of curious, how are you and the Board sort of thinking about capital allocation, particularly with the new credit facility? And where I'm going there specifically is M&A. I mean it feels like Tenable has always been thoughtful in terms of M&A in the past. How do you think about that M&A strategy sort of going forward? Does that make sense?

Amit Yoran - *Tenable Holdings, Inc. - President, CEO & Chairman*

Absolutely. I think the capital is certainly -- a major portion of that is to continue to invest in the business with increased confidence in the momentum that we're seeing and the opportunity that's in front of us in the market. So you'll see that occur both organically through continued innovation, adding new feature function capability and differentiation in our core market as well as adding new asset types, greater visibility, improved analytics to the products. You'll also see, I think, a continued focus on inorganic moves.

We're really excited about the position that we have with OT. The pace with which that market is starting to wake up and recognize, especially in light of the outages caused by the convergence of IT and OT around Colonial Pipeline. I talked a little bit earlier about our Active Directory solution and the incredible opportunity that exists there. And make no mistake about it, it is a bear to secure, and we have market-leading technology there, and there's great market awareness.

And those -- securing those identities is absolutely core to cloud-based deployments. It's absolutely core to remote work. It's absolutely core to zero trust initiatives. So there's phenomenal opportunity around there. And we think that there's other key areas of technology where we can make very exciting acquisitions and continue to position the company for long-term growth.

Saket Kalia - *Barclays Bank PLC, Research Division - Senior Analyst*

Got it. That's really helpful. Steve, maybe for my follow-up for you. You touched on EP a little bit and realizing it's still early, can you just talk about any sort of early observations on how it's sort of impacting an average deal size? Anything else that you're sort of seeing in bundling generally? Anything on EP and sort of bundling would be helpful because it sounds like it's off to a good start.

Stephen A. Vintz - *Tenable Holdings, Inc. - CFO*

Well, it is. And what we're excited about is it addresses a larger problem for our customers, our ability to test risk holistically as EP includes VM, WAS, Container Security and Lumin. The one thing that I'll say about EP is that it is driving higher deal sizes. It's no surprise that we're announcing really strong 6-figure deals. I talked about the pipeline that we're building even specifically for EP, not only in $100,000, but $250,000-plus deals. And the average deal size is about 55% to 60% higher than if we would sell core VM on a stand-alone basis.

So over the past few years, we made a lot of investments in R&D. We brought new product to market. The pricing and the packaging and those products, we think, are going to continue to be a good catalyst and enabler of growth and our sales team is having success selling that into the account base and also winning new opportunities as well. So you'll see that continue to evolve. EP does not include Active Directory, does not include OT, does not include some other things. So we think there's -- we're demonstrating the ability to monetize some of the investment in R&D. And we think there's also ample opportunity to continue to see further monetization and even higher selling prices.

Operator

Our next question comes from the line of Mike Cikos with Needham & Company.

Michael Joseph Cikos - *Needham & Company, LLC, Research Division - Associate*

First question I wanted to tap into, I know that you guys are making these investments you're calling out in the sales and marketing arm specific to adding quota-carrying reps. Just curious, can you give us a feel for the order of magnitude at which you're growing the headcount there? And then the, I guess, the build on to that would be, how long does it take for these new hires to become fully productive? What is it you guys are doing to ensure that these new hires are maintaining or improving the productivity rate that Tenable is usually delivering?

Stephen A. Vintz - *Tenable Holdings, Inc. - CFO*

Yes. This is Steve. So we are adding quota-carrying sales reps. It's something we talked about at the beginning of the year. We continue to add quota capacity in Q2. Our plan is to -- probably in the second half of the year, our expectation is that we'll add more quota capacity in the second half than even in the first half. So just given the quality of the print and the competence of the business, we feel like that is the right thing to do. And we're doing this in a way that still allows us to generate the kinds of margins and free cash flow that are necessary in the company. The average ramp is about 10 months. So it will give you a sense of when we expect reps to be fully ramped and contribute.

And the last thing that I would say there is not -- it's not all about just direct investment and direct expansion of the sales force. We are the only company in our space that has made a 100% commitment to the channel. And the channel continues to bring us more inbound opportunities perhaps than in any other time. So -- and notwithstanding the investments that we made in channel, we're also continuing to make investments in MSSP.

So the combination of adding quota capacity and the expansion of the sales force, continuing to optimize and tune the channel to drive higher levels of performance, and they allow us to open doors and to opportunities that we probably would not otherwise see and then also the investments in doubling down of MSSP, which is even though it's on a small base of business is one of the fastest-growing areas of our company, and it's a new route to market for us. We're trying -- we're pulling all those levers, and that's what's flowing through in the spend for sales and marketing, and we expect that to tick up sequentially in the second half of the year.

Michael Joseph Cikos - *Needham & Company, LLC, Research Division - Associate*

Very helpful. And if I could just tack on one more. I'm trying to think about Tenable.ep. And I understand it's a much more strategic holistic decision-making process for your customers, especially with Board members, this being top of mind or the C-suite getting involved. Could you help me tie all that back into what you guys are seeing on sales cycles? I'm just trying to parse through those 2 items because obviously, your results are telling us something different, but I would have expected that these more strategic decisions would be extending your sales cycles to a certain extent.

Stephen A. Vintz - *Tenable Holdings, Inc. - CFO*

I think that's probably a fair observation that there -- it is a more strategic decision, and there may be some impact to sales cycles because you're seeing it as a more strategic procurement from the customers. Hopefully, that also results in -- the early indication is this resulting in significantly larger transactions and probably stickier relationships with the customer.

From our perspective, EP is beyond just, hey, there's an enterprise licensing component to it. It really is a platform-based sale and aligning our capabilities across the platform with our customers' desire for increased visibility and increased understanding of cyber risk. So again, we're no longer focused on this web application scanner versus that web application scanner. It's really being able to bring together an understanding of web app scanning and container security and cloud security and other IT asset visibility and understanding what the correlation is between those and how those translate into enterprise risk.

So as cyber risk becomes a more strategic conversation between the CISO and the Board, we think this platform-based approach is critical. And the sales team has gravitated toward it and embraced it and I think in part because customers understand it and seem to be embracing this concept as well.

Operator

(Operator Instructions) Our next question comes from the line of Jonathan Ho with William Blair.

Jonathan Frank Ho - *William Blair & Company L.L.C., Research Division - Technology Analyst*

Congrats on the strong results. I think you indicated in the prepared remarks that IO was outgrowing SC. Is there an inflection point here? And is there any sort of potential impact to either billings or revenue that we should be thinking about if we do see maybe a faster shift over to IO?

Amit Yoran - *Tenable Holdings, Inc. - President, CEO & Chairman*

Yes, Jonathan. I think the work-from-home movement has certainly created demand and pull-through for our IO platform. But one of the things that customers really like is it's flexible deployment so we can go on-prem in the cloud, so we don't -- often customers choose both, and its ease of use.

So for us, we're continuing to grow the top line at very healthy levels, and we continue to see customers increasingly choose IO and standardize on IO as their VM platform versus on-prem, but often we sell both. And it's something we first added a couple of years ago, even when we went public, we just said in a few years that just given how workloads are moving to the cloud and just buying preferences, that we'll continue to see a higher mix of business for IO relative to on-prem offerings.

The good news is that we're flexible in terms of how we deploy and how we serve customers. Some markets, customers have a bias towards on-prem. And other markets, clearly, there's a bias towards buying and delivering from the cloud.

Jonathan Frank Ho - *William Blair & Company L.L.C., Research Division - Technology Analyst*

Got it. Got it. And then can you maybe give us a little additional color around sort of your comments with OT? How do we think about sort of the Colonial Pipeline breach? And maybe specifically, the timing of when companies start to increase their spend or when those companies start to fall into the pipeline. Are you seeing your phones ring off the hook? I'm just trying to understand sort of how to think about the timing of when that maybe translates into bookings or revenue.

Amit Yoran - *Tenable Holdings, Inc. - President, CEO & Chairman*

Yes. Well, I think that there's a number of things. Great question, Jonathan. I think there's a number of things happening in the OT world, which I would characterize as a broader awakening. Certainly, Colonial Pipeline, front and center and the thing that Colonial Pipeline really highlighted was the convergence of IT and OT. It's something that we've been vocal about for years. But you cannot assess the security of a pipeline without also understanding the IT environment that is integral to those control systems and to that operational environment.

So we think we're coming from a position of strength. Customers are certainly -- and prospects, are certainly understanding that. So it has increased awareness, a number of -- and not just Colonial Pipeline, but water treatment facilities and attacks against pharmaceuticals and folks in the health care industry recently, really highlight the convergence and the opportunity in front of us. These are not overnight conversations. These are processes that are -- and sales cycles that are very deliberate.

What we're seeing now is a lot of pilots, a lot of evals. We're seeing early deployments, so a facility or an organization which may have 250 facilities around the world is deploying in 15 facilities first and testing the products and understanding what is the most efficient path for deployment, the most efficient method for managing a larger architecture like this. And over time, with success, we believe we're going to see -- and they're going through the budget cycles, and we believe they're going to translate into much larger opportunities down the road.

Outside of high-profile breaches and attacks, there have also been, in addition to the cyber EO, the administration has also released another executive order specific to the energy sector, and you're seeing 100-day sprints first in the energy sector and then soon to be in other sectors, really looking for capability and trying to jump start a focus on cyber security in some of these industries, which historically have lacked behind in progress around cyber, and certainly lack well behind the threat that they're dealing with.

Operator

Our next question comes from the line of Joel Fishbein with Truist.

Joel P. Fishbein - *Truist Securities, Inc., Research Division - Research Analyst*

Amit, just for you. You -- I wanted to see if you can maybe expand on the Deloitte partnership and some of the system integrators and some of the programs that you're doing with them and how that might be driving some of the larger deals.

Amit Yoran - *Tenable Holdings, Inc. - President, CEO & Chairman*

Yes, Joel. Great to hear from you. So I think highlighting the partnership with Deloitte, specifically around an initiative they have for smart cities and smart infrastructure, where we've deployed our OT solution alongside other capabilities that they're showcasing and touring customers through and prospecting, they expand -- as they educate them on the full imagining of what technologies can bring to the table. So we're excited about that partnership, in particular, but the systems integrators more broadly helping their customers understand cyber risk, and we think we're an integral part of that understanding. So both on the OT side as well as on the IT side.

Operator

Our next question comes from the line of Brad Reback with Stifel.

Brad Robert Reback - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Senior Equity Research Analyst*

On the growth in quota-carrying capacity, any reason we shouldn't expect that to expand at least in line with revenue, if not faster?

Stephen A. Vintz - *Tenable Holdings, Inc. - CFO*

Well, different reps have different quotas and there are different geos. So while there is some relationship, it takes time to ramp, and there's not a perfect corollary. And as I also mentioned earlier, some of this is going to be on the commercial side, which is our mid-market business. We're applying some of the lessons and best practices that we learned during COVID, which is our ability to continue to close and transact deals here remotely and even larger deals to our go-to-market motion.

But there is obviously a relationship. It's one of the reasons why we called it out, and we're continuing to make investments and add capacity. But in addition to that is continuing to get traction with the channel, even doubling down on our MSS -- our efforts via MSSP.

Operator

Our next question comes from the line of Kingsley Crane with Berenberg.

William Kingsley Crane - *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

Congrats on a great quarter. With customer adds, even excluding Alsid, if we look at revenue growth and CCB growth, can you provide any more clarity on those figures ex Alsid?

Stephen A. Vintz - *Tenable Holdings, Inc. - CFO*

I'm sorry, you broke up and weren't audible. Can you repeat the question, please?

William Kingsley Crane - *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

Yes. Could you provide any more color on revenue growth in CCB ex the Alsid acquisition?

Stephen A. Vintz - *Tenable Holdings, Inc. - CFO*

So Alsid closed late April. So the results that we're reporting today only reflects about 60 days of activity. And really, during that time, we've been hard at work on integrating the businesses, creating enablement programs for our sales team and hard at work on building pipeline opportunities. And one thing I will say is that out of the gate, we had some really good momentum. Pipeline activity -- pipeline and the activity levels are high, and we're excited about the second half of the year. And keep in mind as well, just given sales cycles, you're more likely to see a greater contribution from Alsid Q4 versus Q3.

William Kingsley Crane - *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

Okay. That's fair. And just one quick follow-up. So great to hear the traction with Tenable.ot as a public utility company as a result of a cross-sell. So when you look at the revenue base for Tenable.ot today, how often are customers cross-selling into that product? And then how often are you landing with OT?

Amit Yoran - *Tenable Holdings, Inc. - President, CEO & Chairman*

Yes. I don't know that I have a percentage of the cross-sell or how often we're landing with OT. But certainly, our sales motion contemplates that we've got a very large customer base, 35,000-plus customers around the world and thousands of those on the enterprise platforms and with a very strong degree of trust and confidence in the Tenable brand and also come to rely on Tenable for helping them understand their cyber risk.

Increasingly, over the last 18 to 24 months, we've seen CISOs being given more and more responsibility for operational technologies and operating environments. And so having a mature capability in that segment of the market allows them to expand their relationship with us into those environments and gain the visibility that they are looking for in a way that they're used to consuming it and processing it and understanding it. So we feel like we have a very strong go-to-market motion. We're getting a fair number of at bats and then differentiating ourselves with the ability to assess both IT and OT in these operating environments, which have both platforms and ultimately can be susceptible to both forms of risk and exposure.

So we think that's a key differentiator for us and seems to be playing itself out pretty consistently with the [app]. It's just a matter of these are slow-moving markets, and early in their adoption cycles and we anticipate there to be much stronger, longer-term growth there over time.

Stephen A. Vintz - *Tenable Holdings, Inc. - CFO*

And then -- this is Steve. The one thing I will say is, looking at the investments in the second half of the year, we're absolutely focused on investing more in OT. Penetration is still relatively modest. The market opportunity is large. We do know that when we're first in an opportunity that success rates and close rates tend to go up. So you're going to be seeing incremental investment from us to focus on greater coverage and greater focus in this market.

So given the strength of what we saw in the first half of the year, and by the way, OT is helping drive the expansion of the (inaudible), you're going to see incremental investments in the second half of the year, specifically in the OT side of the business.

William Kingsley Crane - *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

Congrats again.

Operator

Our next question comes from the line of Gray Powell of BTIG.

Gray Wilson Powell - *BTIG, LLC, Research Division - MD & Security and Analytics Software Analyst*

Congratulations on the good numbers. So I want to follow up on an earlier question. You mentioned cloud adoption in Tenable.io a couple of times as a driver of upside. Can you maybe give us a sense, even a ballpark sense, to sort of the mix of new and add on from Tenable.io? Or maybe just how much faster it's growing versus the overall business in sort of the low 20% range?

Amit Yoran - *Tenable Holdings, Inc. - President, CEO & Chairman*

So today, we're reporting CCB growth of roughly 23%. I think it's fair to say just given the mix -- the change in mix that we're seeing greater growth in IO and related cloud products. And so we -- that's something that we anticipated over the last couple of years, so kind of reflects how workloads are moving to the cloud. So yes, we're seeing higher growth I think it's fair to say in terms of cloud. That sort of corresponds with greater investment and greater focus for us. But absolutely, unequivocally, our on-prem and SC offering is paramount to our success, where we have high renewal rates and high customer satisfaction rates. So I think it's really the combination of both together and our ability to deploy both in terms of on-prem and in the cloud that's really resonating well with customers.

Gray Wilson Powell - *BTIG, LLC, Research Division - MD & Security and Analytics Software Analyst*

Understood. Okay. And then just last one. It was great to hear the positive commentary on U.S. Fed. Can you remind us just ballpark like the mix of revenue that you drive there? And do you see that changing significantly in the next 6 to 12 months?

Amit Yoran - *Tenable Holdings, Inc. - President, CEO & Chairman*

I think ballpark, plus or minus 15%. And it's been a high-performing segment to the market for us for some time. We think we have a significant position of strength in that market, and we see that continuing. I don't think at this point we can point to any specific indicator and say this -- we expect this percentage to vary or change significantly in the near term.

Operator

Our last question comes from the line of Shebly Seyrafi with FBN Securities.

Shebly Seyrafi - *FBN Securities, Inc., Research Division - MD*

So in terms of gauging the upside here, both on the revenue and the number of enterprise customers added, I think you called out public strength and investment in products I think that you meant Tenable.ep ramping. It came out in February. So which of those 2 factors, public or Tenable.ep, was the larger factor would you say in terms of driving the upside?

Amit Yoran - *Tenable Holdings, Inc. - President, CEO & Chairman*

I would say public sector just only because the deal sizes tend to be much, much larger. I mean they're very sizable and not just 6-figure, but also 7-figure deals. We've always had a very strong foothold in the U.S. public sector. We serve most 3-letter federal agencies, both on the defense and the civilian side. So certainly, that was of note. That's one of the reasons why we called it out. And our momentum in large deals is certainly apparent here given the strength in the quarter.

But there's also sizable opportunities. We've had success with Tenable.ep. And this is a product that we launched in the end of February, and we were able to close some deals in the first quarter, but now with a full quarter under our belt, even if it's only been just a few months, we are pleased with the success and it's helping us with -- in terms of sales cycles as well.

Yes, there are larger ASPs. There's a clear corollary between selling prices and sales cycles. The larger the deal, the longer the sales cycle tends to be. But we now have -- with EP, we have -- it's a single integrated offering, and it's a much smarter way for customers to consume technology as opposed to selling a la carte and separate SKUs on a purchase order, which often comes with more scrutiny and more review. So notwithstanding the higher selling prices, we're actually having success selling EP to larger enterprises and in a way that's allowing us to impact our growth here short term.

Shebly Seyrafi - *FBN Securities, Inc., Research Division - MD*

Okay. And last one. You said your gross margin you expect to be similar in the back half from Q2. Q2's gross margin did tick down. Was that tick down due to ramping IO? Or were there other factors? And when do you think you can return the gross margin back to like last year's levels of like 83% plus?

Amit Yoran - *Tenable Holdings, Inc. - President, CEO & Chairman*

Yes. I think just directionally in terms of gross margin for us, one of the things we've talked about years ago is that we expect gross margins to settle in the low 80% to high 70% range. And just given the mix of business and the shifts that we're seeing, we do -- we think that's fairly consistent. I think we have confidence it will be at the higher end of that range versus the lower end.

I think what you're seeing in terms of gross margin in the second quarter is that even though the Alsid acquisition is new, it reflects 2 months of incremental expense associated with Alsid. And a lot of these costs here, not just Alsid, but also in our business as we continue to expand our geographic and international footprint, a lot of the costs for these public cloud platforms are semi-fixed. So they're not variable. So it requires investment upfront. And then those are costs that you'll fully absorb over time as you achieve scale and growth in those geos.

So for now, we're saying, hey, it's going to be flat in the second half of the year, just given the growth and the investments that we're making. But we also feel good over the past couple of years that our gross margins have exceeded our own expectations in the guidance that we gave when we went public.

Operator

This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation. Enjoy the rest of your evening.