48th Annual J.P. Morgan
Global Technology, Media and Communications Conference
May 12-14, 2020 | Virtual
#JPMTMC

Tenable

Tenable presentation delivered at the 48th Annual J.P. Morgan Global Technology, Media and Communications Conference - Virtual on Thursday, May 14, 2020 at 10:10 AM

[music]

Sterling Auty: Thanks to everyone for joining us. My name is Sterling Auty, software technology analyst here at J.P. Morgan. This is day three of the 48th Annual TMC Conference here at J.P. Morgan. Very happy to have with us for our next session, morning, the national team for Tenable. We have both Amit Yoran who is CEO and Steve Vintz who is CFO.

Hey, guys, thanks for joining us.

Amit Yoran: Thanks for having us, Sterling.

Steve Vintz: Thanks, Sterling.

Sterling: Listen, we really appreciate it. Actually before we get started, just a little info for the participants. If you like to ask a question, please go ahead and hit the Q&A button at the bottom and type in your question.

I'll go ahead and include it in our session as we go along. With that, Amit, maybe just to get us started for those that are not as familiar with Tenable, where does it sit in your role cyber security landscape?

Amit: A lot of folks think of Tenable in the vulnerability management space. It's where the company's root are, starting out being in. We're the largest, strongest, and fastest growing company in that space.

If you're not as familiar with the security space, or as you think about the evolution of the company, it's really helping enterprise answer this question, "How secure am I? How at risk am I? How can I most efficiently manage or reduce my risks?" So helping folks identify their systems, where and how they're exposed, and how they can efficiently reduce their enterprise risk.

Sterling: When you look at the market overall, we tend to think about a number of the vendors in cyber security either servicing low to mid-market or enterprise. Where is your sweet spot?

Amit: We have a solution set that is broadly applicable. It's very diverse in terms of geo, in terms of industry, in terms of segment. The majority of the company, at this point, is squarely addressing the needs of the enterprise markets. We've got about three-quarters of our customers on our enterprise platforms and really servicing that market [inaudible] .

Sterling: I think what's top of people's minds, at the moment, is COVID-19 and the overall environment. Can you give us a sense of what did you experience in your March quarter? What kind of impacts is the business seeing?

Steve: Hi, Sterling. This is Steve. I'll talk a little bit about the demand environment. Amit, feel free to interject with the impact of VM as a whole. In Q1, we had over 300 new enterprise customers as well as a healthy number of net new six-figure customers. We continued to see good activity in both new and expansion.

On the earnings call, we did say that while pipelines continue to progress very well, we're seeing positive developments both in terms of the size and maturity of the pipe. That we do expect an impact on new logos and to a lesser extent rental business. While it's difficult to gauge right now, we're pleased with the fact that we have a very broad go-to-market capability.

We have offices in over 35 countries. We transact sales in 160. We're in most major sectors of the economy. Given the health crisis right now, different countries are at different stages of the recovery. That's why we think it's important to have a broad go-to-market effort.

Sterling: How have you been able to attract the new logos in this environment? That seems to be the one area that a lot of vendors are not complaining about but just identifying as being a challenge.

Amit: There's some number of logos that are new to us that are converting, that are takeaways from primary competitors or legacy VM solutions. There's a certain natural gravitation to Tenable as the market leader [inaudible] investment and growth in the space. There's also, I think, broad recognition that understanding your vulnerabilities is both critical from a risk perspective.

As boards, audit risk committees, CEOs get more engaged in cyber issues, their first natural question is, "How big of an issue is this? How secure are we? How at risk are we again?" There's again a natural gravitation toward vulnerability management. There is some number of takeaways from primary competitors.

There's also a substantive number of greenfield accounts, which may come as a surprise to many investors. It certainly came as a surprise to me as we started measuring this more carefully over the last two to three years. What we find is in any given period, a quarter to a third of our new large enterprise transactions are coming to us from greenfields.

They have no organic VM program. They're relying on an audit from a Big Four, some consultancy, and using that to assess risk. That's simply insufficient in today's operating environment. COVID or not, I think there's a natural desire and requirement for business leaders to understand cyber risk. Tenable represents the most foundational way to do that.

Sterling: Why should it be a surprise that in vulnerability management that you're still finding greenfield opportunities?

Amit: That's a great question. I saw you almost laughing [laughs] as you read the statement because it seems so counterintuitive.

I say it seems counterintuitive because vulnerability management has been around for a long time. It's about a 20-year-old market, give or take. It seems so intuitive to anybody that's been in and around security. Of course you would be doing that.

I think that greenfield really represents those enterprises which shouldn't have corporate leadership engaged in cyber security. They're relaying on an annual audit, or they didn't feel the need to get engaged in cyber security and say, "We have a firewall and so we're secure."

What they've learned is no, that's absolutely not the case. Regardless of what security, protective measures you put in place, you have to exercise good hygiene. The way to assess that and the way to assess risk is really through these types of programs.

Sterling: Is there any change in terms of the type of solution or the use case that customers are coming to you for in this environment versus prior to COVID-19?

Amit: It's early in the changes in work environments to say definitively this is the trend. I think there are some intuitive motions that make sense. Seeing increased adoption of cloud-based infrastructure, increased adoption of work-from-home populations does mean that you'll want to exercise different types of approaches to understanding risk.

That's where Tenable brings a very flexible set of technologies whether you want to use a management-based approach, a cloud-based approach, an on-premise-based approach. What we have seen also is that there's a real change in the operating environment.

It's not like folks have abandoned their corporate networks -- they no longer have data centers, they no longer have on-premise applications and servers that they have to maintain security for. They now have this new, expanded attack surface that they weren't anticipating.

The flexibility of our technology to allow people to assess all the different aspects of their attack surface is critical, as well as helping them prioritize what to address. IT teams have never been busier. They've got to not only maintain their infrastructure, they've got to make this new working-from-home, remote workforce efficient and give them the access they need and try to secure it.

Security teams really need to prioritize what am I going to go talk to IT operations about? What's most critical? What really matters from a risk perspective? That's where our analytics really become compelling.

Sterling: What did you say in terms of close rates in this COVID environment as you hit the end of the March quarter? What's happening thus far? Listen, we know the linearity is back-end loaded for all software companies. What can you comment to in terms of the close rates, thus far, in June?

Amit: We said in Q1 that, despite adding a healthy number of new enterprise platform customers and a good number of net six-figure customers, that we would have liked to have closed a few more deals. We did see some impact on the close rates. We were dealing with three weeks of the pandemic in the first quarter and now we're dealing with a whole three months of it.

The good news is that activity levels which would come before are good and pipeline, in terms of size and maturity, is healthy. Like most software companies, we're back-end loaded. It's not unusual for software companies to close 50, even 60 percent of their total new sales in the June quarter.

We understand that closing new deals is going to be more important now than ever. We think we're reasonably well-positioned, but we do expect some impact. With the crisis comes a greater degree of uncertainty. We also know, too, and this is according to a recent "Fortune" survey, what, 60 percent of large companies expect to accelerate their digital transformation effort?

One of the secular tailwinds for us was companies having to go digital transformation. With that, more connected devices, the attack surface expands.

This is going to bring a new set of challenges for organizations and a new set of security challenges, in particular, that we're hoping to solve and address along the way.

Sterling: What do you see in terms of, one of the other comments is, customers asking for flexible payment terms, maybe changes in contract duration? What have you experienced thus far?

Amit: Well, with regard to payment terms, our expectation is that we will see more customers. We have seen more customers ask for some payment terms.

Some verticals are more challenged that others, if you look at transportation, healthcare, and hospitality. In aggregate, it's less than 10 percent of our total revenues. Those sectors have been impacted more than others.

We are starting to see some of it. However, what mitigates the risk a little bit for us is that we do two-tier disti. Every deal that we transact goes through the distributor. It goes through the reseller. It significantly mitigates the risk. We don't have to track collections in 100 and 120 different countries.

In that regard, we feel pretty good. What was your second question, Sterling? Can you repeat?

Sterling: Contract duration and payment terms.

Amit: I'm glad you brought up contract duration. We disclosed CCB, calculated current billings, which is the change in short-term deferred revenue over revenue. It's a close proxy, not a perfect proxy, of bookings.

We run the company on ACB bookings. Quarters are based on ACB bookings. Compensation is tied to it.

CCB, in an environment like this, is probably less meaningful as a leading indicator to revenue. Not only is it predicated on new closing deals, close one business, but it's also influenced by early renewals and also multiyear prepaid deals.

Our expectation is that we will see probably less customers inclined to pay three years up front than we've seen in maybe, otherwise, stronger markets. CCB, for that matter, becomes probably less roll-in for us. Less roll-in is a leading indicator to revenue growth itself.

Sterling: Within the increased work from home, it's a lot more devices that are outside the corporate firewall than what they've seen before versus inside. Companies have been concerned that their opening up additional attack vectors there and a different attack surface. Does that pull through increased either usage or upsell opportunity?

Steve: It's a journey for most companies. As our customers shifted to a work-from-home environment, we opened up much greater flexibility on licensing around adopting, tenable.io is our cloud platform, and also increased usage of agent-based technologies for those folks so that they could assess the systems without chewing up additional VPN, precious and loaded VPN bandwidth, and so on and so forth.

There certainly is the opportunity for increased licenses, if that becomes the new norm for folks. Our anticipation is some number of those devices will came back on corporate networks. Is it more of a shifting of this type of license versus that type of license?

It's early in the process to see what compute will really look like post-COVID. We aren't anticipating a major tailwind of new license revenue. It may be a slightly different mix than we've seen historically.

Sterling: Tenable is one of a small group of companies that actually has its founding either on or related to open source technology. Can you walk us through what the portfolio stack looks like today and how you're able to leverage some of those open source roots?

Steve: Yeah, as you mentioned, we started off with an open source technology to help people assess, or they scan a system and assess, "What are the known vulnerabilities that system is exposed to?" so you know what software needs to be patched, what fixes need to be applied, and what configuration settings need to be changed to be secure.

Over the years, that open source technology was closed source but maintained a free license, and then people called it a beloved product, Nessus, where we've had two-plus million cumulative downloads and users of that, which is actually very close in proximation to the subtotal of security professionals. Everybody has used, or currently uses, Nessus. It's the gold standard for how to assess systems to risk.

It becomes a tremendous source of intelligence for us in that people are constantly testing systems with it, providing us feedback, "Hey, this fix needs to be improved with these changes," or, "I've got a new vulnerability I've discovered. Here's how to look for it using Nessus."

There's all sorts of advantages and a cumulative effect of that over a course of decades. We do have a professional version of that product, which is a for-fee license, Nessus Professional, represents about 20-plus percent of our revenue.

That is, if you want to scan larger numbers of systems, "I want to look at 10,000 systems. I want to audit 10,000 systems on my network." There's a natural progression from freeware to paid on your license using Nessus Pro.

Then, beyond that, we have our enterprise platforms, which currently account for 70, 75 percent of our sales. In those enterprise platforms, you have enterprise types of functionality, so the ability to control multiple scanners.

You may have a large enterprise that has 30 or 130 scanners on a global basis. You may want more flexible assessment technology, not just scanning, but you may want agent technology. You may want passive asset discovery.

You may want native cloud connectors to the three major cloud providers, the integration and understanding of the security of your OT environment, as well as more complex [clears throat] reporting analytics, "What do these vulnerabilities mean from a risk perspective? How is that trending over time? How am I benchmarking relative to my peers?" and a much more robust set of APIs to integrate with your logging solution.

You have patch management, configuration management solutions, and other IT operations to give management capabilities. There's a very natural progression from freeware to professional version, and then professional version to our enterprise platforms.

The company's largest segment of growth, over the course of several years now, has been in that enterprise segment.

Sterling: That's a good segue into how would we think about your SMB exposure and what are you experiencing there, because investors are most concerned about SMB, number one, and then those that are in those hard-hit industries like transportation.

Steve: We're an enterprise software company. We sell to large and even mid-sized organizations. That's most of our revenue. We do have some smaller customers. A lot of people think of Nessus as an SMB product, given its price points. It's sold as an annual subscription and can range from anywhere from $2,000 to $10,000 per annum.

While there is some SMB concentration in Nessus, the preponderance of Nessus is really from a security community, specifically pen testers. We think those dynamics are a little different than smaller companies. If you look at vertical concentrations, we've talked about this earlier, our largest verticals are public sector, specifically the federal government. It's about 15 percent of our revenues.

We also have stronger concentrations in financial services, healthcare, technology. Those have been areas of strength. On the retail side, there's a difference between the consumer good companies and ones that are selling primarily to consumer. In aggregate, if you look at the exposure for transportations, hospitality, and retail, it's about 10 percent of our total revenue.

We think that brings good balance. We're continuing to monitor things closely. We take comfort in the fact that we sell primarily to mid and large organizations, and we're an enterprise software company. That's probably a better place to be than companies that are focused primarily on SMBs where it's more susceptible to the health crisis.

Sterling: How do you drive the upsell, cross sell? In other words, what's the tip of the spear when you get into an enterprise? Are you starting with Nessus Pro and working your way up, or do you land with some of those enterprise platforms? How do you drive that, like I said, upsell or even expansion?

Steve: We can land one or two...

Man: Hi, Steve.

Steve: I was going to say we can land one or two ways. Increasingly, we're seeing a greater number of new enterprise platform customers. We ended up with 300 in Q1, over 400 in the fourth quarter. That's been a primary area of focus, continuing to bring new customers into the franchise as an enterprise platform customer.

Amit mentioned that 30 percent or more in any given quarter can be greenfield. That speaks to how the VM market has evolved from compliance-driven to one that's a foundational part of your security program. Also, we have a product in Nessus, which is a cost-effective on-ramp into a larger platform sale. It's one that is seen at the market.

The free version of Nessus has been downloaded two million times cumulatively over the past 15 years. Most security professionals have used Nessus, or are using Nessus, during their lifetime. We also have customers that come in, use Nessus, and step up to a larger enterprise platform sale.

We can land multiple ways. You can come into Nessus, and then step up and make that larger purchase, or you can come directly into the enterprise platform. Regardless, when you do, we see considerable expansion. Customers increasingly look to us to secure more of their assets.

There's more assets come online, and Gartner estimates will be over 20 billion connected devices over the next couple of years. The compute environments are not static, they're very dynamic. As customers add more digital technology and engage in more digital transformation, increasingly look to us to secure more of those assets.

Asset coverage is one vector of expansion. The other is really product. We've launched a number of new products over the years. We've talked about Lumin here and the commercial appeal that that potentially has. We have a Webs product, Container Security, a number of other products that we're excited about.

We think the combination of assets and more products will provide a continued expansion within the base. It's one of the reasons why we have these very healthy net dollar renewal rates that we're very proud of.

Sterling: 2019, you guys crossed over, became the largest vendor in vulnerability management and continued to be the fastest growing. What do you attribute that success to? How are you able to gain that market share?

Amit: Especially as you look at the enterprise market segment we're focused, the market's spoken time and again that best of breed matters. Those enterprises really want to understand what their risk is, what their exposure is. They go out and they test products, they evaluate products, they compare products.

Our level of investment each of last three to four years, we invested more in VM R&D than our next two public competitors combined. You just do that cumulatively over the course of years and the cumulative effect is absolutely tremendous. We simply have a better product. We cover more CVEs than our next closest competitor. Not 2 percent more, you have 20, 22 percent plus more vulnerabilities.

We test our product to Six Sigma accuracy in terms of false negatives and false positives. When you do that, and when you have that type of differentiation in the product, enterprises that take the time to test, that take the time to understand the difference can appreciate that.

That results in higher win rates and integrated growth rate in the VM product, and also investing in not just a better VM product but also a more modern approach to vulnerability.

Looking at not just traditional assets, looking at cloud-based infrastructure, looking at cloud-based assets, looking at the operational technologies, looking at containers and DevOps environments, enhancements to Web application assessments.

It's a better, more accurate assessment of your attack surface and a bunch of new analytic approaches looking not just at level and types of vulnerabilities, but how exploitable are they, how critical are the assets, what does this mean from a risk perspective, and what are the actions I can take to most efficiently reduce risks.

Sometimes a single patch may supersede three, four other patches and configuration changes, and address dozens of vulnerabilities on more or less critical systems. It's easy to say we can guide an automated remediation or guide efficient remediation. To do that in the wild, really, is a very complex form of analytics.

All of these types of things prove to our customers and to the market that, in the enterprise segment, we bring the greatest capability and that results in growth rate.

Sterling: Qualys has suggested that one of the reasons that you're growing faster and one of the reasons that you're bigger is that you're not 100 percent subscription-based, that there's a difference in the business model. Is there that much difference in terms of business model that would cause a meaningful change in terms of either growth rate or size of revenue?

Steve: The short answer is no. Despite contrary belief, while we do sell some perpetual licenses, the revenue recognition is not upfront. It's over five years. Selling a perpetual license actually creates a longer revenue recognition period. Selling a subscription, therefore, means you would recognize more of it upfront, you would recognize the subscription over the term.

At the end of the day, we're predominantly subscription. We have 90 percent recurring revenue. We have over 80 percent gross margins. We have a product in Nessus that has been a cost-effective, more ramp-controlled, larger platform sale.

We're completely focused on this market. We have a lot of confidence in the market. We think it makes a difference in terms of competitive differentiation, in terms of win rates. It's one of the reasons why you see the inflection in new logo ad.

The data points that we provide to Wall Street provide a lot of transparency on the business in terms of how many new customers are we adding, how many large customers are we adding, and just even the CCB itself and what level of sales as a result of that. We feel really good about the tailwinds in our business.

We know that the health crisis will impact our company or will have some impact on the business, but we think it's best to be focused in the enterprise, best to be focused really on the VM market itself and not adjacent or ancillary markets.

Sterling: Typically during downturns, I expect the margin profile of companies to actually get worse. When I look at your outlook and I look at what you produced in the March quarter, not only generated growth but it looks like the margin profile is getting meaningfully better.

How are you managing expenses? How are you able to still get that top-line generation while not contracting but reining in some of the spend?

Steve: We're very proud of the March numbers that we've achieved to date. If you look at the beginning of the year, we've guided at the midpoint a loss of $.35 for the full year, with a loss of $.17 in Q1. Instead of $.17 in Q1, the print on the pro forma basis was $.08. There was some notable upside in EPS.

Some of that was due to revenue. We said one to two pennies was COVID-related, less fuel marketing, less travel. The preponderance was really on the expense side and greater operational efficiency. In Q2, we guided to a loss of $.46.

Also, for the first time since we've been public on a sequential quarterly basis, sales and marketing actually was lower on an absolute dollar basis in Q1 versus Q4, despite having a number of industry events and upfront costs related to SCO when worldwide sales kick off.

One of the reasons why, Sterling, is because despite making investments in sales, adding capacity, and also investing in new areas of the business to drive innovation and bring new products to market, we are demonstrating a greater level of efficiency and able to balance those investments a lot more.

Now that we have critical mass in certain markets, when we had a sales rep, no longer do you need to have all of the associated overhead that goes with it to greater efficiencies there. With every investment in sales rep, you have anything from a sales development rep, a channel manager, a field marketing person, a sales engineer.

We're able to achieve a greater level of efficiency given the investments that we've made to date on a historical basis. Going forward, you should expect that story to continue. Continuing to invest because we believe in this market.

As you mentioned, we are the largest company in our space, and also continuing to balance that with a greater degree of efficiency. Overall, the cash flow characteristics of this business are very attractive.

Sterling: Amit, the 2008 to 2010 Great Recession, you weren't at Tenable at the time, but you've been in cybersecurity as long or longer than I have. What were some of the things that you've learned being an executive and managing through that timeframe that you can take away and apply to how to run Tenable during the current economic environment?

Amit: Just because I hadn't shaved my beard and showing a little bit more light doesn't mean I've been in security longer than you, Sterling. Nice try there. First of all, steady hand at the wheel. It's easy to overcorrect in one direction versus another direction during these times of uncertainty.

Especially, COVID has been a very different type of downturn than we've seen previously, affecting not just globally, all sectors, and a much greater degree of uncertainty. Focusing on customers and core value proposition. There may be some decisions and some modes of operating that you decide to push out.

At Tenable, one of the things that we focused on, especially in the early days of the crisis, is making sure that we're very deliberate about investing in our engagement with customers, in quota capacity, in our customer interaction points, our support organization. Also, making sure that we're very deliberate about our roadmap, about our innovation, about investments in capability. You see that play itself out.

Listen, there's been no slow down in the number of new vulnerabilities discovered. You've seen literally hundreds of vulnerabilities published on Microsoft platforms, on Oracle platforms, on core business platforms, over the last couple of weeks.

Having a company that's able to continue to innovate, continue to focus, continue to turn around the speed and accuracy of coverage for those exposures, and help translate to customers what that means to them from a risk perspective is incredibly powerful.

This is an opportunity to really get a much deeper, closer level of engagement and relationship with your customers. Unfortunately, there's other things that you'd like to do, other initiatives that you'd like to invest in that you're deferred and say, "Look, this is not core. We're going to wait on this, or we're going to look opportunistically."

Other companies, other products, and other pieces of innovation in the market are going to have a more difficult time getting adoption, getting funding, getting into, what I mentioned that they might see, in a better market.

Focus on the core. Operate smartly. Also, be opportunistic because there will be some great opportunities for stronger companies, like Tenable, to take advantage of this market.

Sterling: On the competitive landscape, one thing investors are trying to better understand is you do have non-traditional companies, like CrowdStrike, that has modules that they call vulnerability. Is that something that's actually competitive to your core platform? Do you actually see a competitive threat from companies like CrowdStrike?

Steve: We see a competitive threat from most companies, especially in the investment community. [laughs] It's a question that I hear frequently from investors. We don't really hear much about some of these entrants to the market from a customer perspective.

Going back to the comments earlier about a best-of-breed focus, enterprises are looking for real capability in understanding their exposure, understanding their risks. We see great differentiation between us and our pure-play or more traditional VM competitors. Some of these new entrants have far lesser and far less mature capability.

It's not like it's something that we're tracking, obviously. As of yet, they have no meaningful presence from a VM perspective.

We think our level of investment will allow us to continue to differentiate in a more strategic way, not only on the endpoints, but in other increasingly critical parts of the security or the increasingly critical parts to the infrastructure, the cloud-based infrastructure, the web applications, the DevOps environments, the OT environments, and ultimately translating to risk.

A lot of these new entrants are really focused on vulnerability context as they evaluate attacks more than a mature VIP [inaudible] .

Sterling: Makes a ton of sense. With that, Amit, Steve, thank you so much for joining us. Stay safe and stay healthy. Thanks again.

Steve: You, too, Sterling, thank you.

Amit: Thanks, Sterling.

MAP digital, inc.
A Digital Events Agency

Webcasting and transcription services provided through MAP Digital, Inc.