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PRESENTATION

Operator

Greetings. Welcome to the Tenable Q4 2022 Earnings Conference Call. (Operator Instructions) Please note, this conference is being recorded. I will now turn the conference over to your host, Erin Karney, Vice President of Investor Relations. You may begin.

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 fourth quarter and full year 2022 financial results. With me on the call today are Amit Yoran, our Chief Executive Officer; and Steve Vintz, our Chief Financial Officer.

Prior to this call, we issued a press release announcing our financial results for the quarter and full year. You can find the press release on our 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 our guidance and expectations for the first quarter and full year 2023, growth and drivers in our business, changes in the threat landscape 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 and our expectations regarding long-term profitability and free cash flow.

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 those 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 a 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 annual report on Form 10-K and subsequent reports that we file with the SEC, which are available from 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 as 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. - Chairman, President & CEO**

Thank you, Erin. Today, I’ll discuss our financial performance, the strong traction we’re seeing with Tenable One and our growth beyond vulnerability management and exposure management.

With that, let me first touch on our financial performance. In the fourth quarter, we delivered strong revenue growth at 24% year-over-year. In addition, non-GAAP income from operations was $19.9 million and unlevered free cash flow was $32.1 million, both above expectations. For the full year, our results were well above our initial expectations, with full-year CCB growth of 26% and $67.7 million in income from operations.

Additionally, we had another strong quarter with large deals as we added 140 net new 6-figure customers, which is a record for us and is up 40% year-over-year. Even more importantly, the number of 6-figure deals accelerated throughout the year, further validating our corporate strategy and demonstration of the momentum we are building. As the market leader in vulnerability management, we’re seeing great demand in the market, including new customer acquisition, renewals and expansions.

Our years of leadership in VM has put Tenable in a great position to target bigger, more strategic deals as customers continue to move beyond traditional VM to understand and reduce their cyber risk. We believe this is driving the acceleration of 6-figure deals. We had strong performance in OT, including a number of 6-figure deals. This is an early-stage market with tremendous opportunity, where we are now proving our ability to close larger transactions. We also saw particular strength in Tenable One, which I will discuss in more detail shortly.

At Tenable, we continue to differentiate ourselves as a technology leader by continuing to prioritize investments in product innovation and go-to-market, including our partner ecosystem. Over the last several quarters, we have moved quickly to align our efforts where we see the greatest opportunities in the market. And as our Q4 results indicate, we are clearly seeing success. Our decision to focus our product and go-to-market efforts around unified platform is resonating in the market. We are incredibly excited by the traction we’re seeing since launching Tenable One.

Tenable One continues to see rapid adoption and represented mid-teens percentage of total new business in the quarter. Demand was broad-based as we saw healthy numbers of lands from new customers as well as upsell from existing customers across SC, I/O and Nessus. And despite a tougher macro, we continue to see a material uplift with Tenable One relative to stand-alone VM. We’re also excited to note that customers are allocating Tenable One licenses across more of their attack surface, including their cloud infrastructure, truly leveraging the power of the platform.

Selectively, including Tenable One, our exposure solutions now represent approximately 50% of our renewals and new business, up from 40% a year ago. We’re able to leverage our leadership in VM for a natural upsell to Tenable One, making us more strategic in driving larger transactions.

Tenable One brings a single unified view across VM, cloud security, Active Directory and identity and external attack surface management to deliver compelling analytics. Threat actors don’t limit their attacks to one silo of technology. They’re looking for the right combination of vulnerabilities, misconfigurations and account over provisioning that will meet their objectives.

Security teams have been operating on point products and specialized solutions, which created isolation within their operations. Tenable One enables collaboration across the entire security stack. It achieves us to enhanced analytics, asset inventory and building attack path analysis to...
determine which combinations of vulnerabilities, access and permissions, and misconfigurations could result in path from external points to sensitive internal targets.

Leveraging these capabilities, we believe we offer the first platform to truly operationalize preventative security. Operationalizing preventative security has been an objective in the market for a long time. It's really hard to do, and it requires a deep understanding of vulnerabilities, context and prioritization.

It's our long history of understanding exposures at a very deep level that uniquely positions us to deliver on this objective. We believe this gives us an edge with our technology and also in helping our customers security teams operate more efficiently. Connecting related points across security issues enables our customers to have broader visibility into risk across siloed security functions.

Additionally, in these market conditions, security teams need to do more with less. As Tenable One enables vendor consolidation, we are consistently attracting a more senior economic buyer, which is crucial as investments require more scrutiny. A great example of this is a win with a very large global technology and media company. They were going through a large digital transformation, and they were looking at different vendors to secure their cloud, their external attack surface and their VM assets. Tenable One enabled them not only to consolidate vendors, but in doing so, also unified visibility across asset types.

Years ago, we pioneered the concept of exposure management and set out a roadmap aligned with that vision. Tenable One leverages our leadership in VM and realizes the next great step in that vision for managing cyber exposure. Customers and industry analysts alike validate our VM leadership and the importance of cyber exposure. Gartner continues to talk about exposure management as a discipline, in particular, the importance of advancing a cyber exposure management program as critical to developing actionable security posture improvement plans.

We believe their commentary aligns very well with the attributes of Tenable One. Additionally, IDC recently published their 2021 VM market share report, highlighting Tenable as the 2021 market share leader for the fourth year in a row. IDC added commentary around the importance of a holistic view and risk prioritization as the number of vulnerabilities is accelerating every year. As the leader in VM and now a platform-first company, we believe we've earned the trust of our customers to be the vendor of choice as they look to cover more of their attack surface. Since the release of Tenable One, we're seeing an immediate interest and adoption of Tenable One for cloud-native use cases.

Customers are looking to improve visibility into cloud assets, understand exposures and manage risks around this portion of their attack surfaces. This provides a means to consistently enforce cloud security posture and compliance across multi-cloud and hybrid environments that is delivered in a single, unified platform and is more cost effective and scalable than continued use of point provider tools.

In fact, a great example of this was a Q4 upsell for Tenable One within a large aviation company. They saved budget by converting from another cloud security product and instead expanded from Tenable.io to Tenable One.

As we look to 2023, we will continue to focus on innovation, and we'll continue to increase our investment in quota capacity, enterprise customer support, customer experience and our partner ecosystem. While making these investments, we're also delivering a strong annual cash flow guide for this year and reiterating our $240 million to $250 million in unlevered free cash flow target in 2024.

Our ability to deliver profitable growth with investments in innovation and distribution leaves me with great confidence that we will be able to execute on the opportunity in front of us. In short, we're incredibly proud of our ability to execute in this market and look forward to yet another successful year. I'll now turn the call over to Steve for further commentary on our financial results.

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

Thanks, Amit. We are pleased with our results for the fourth quarter, highlighted by better-than-expected growth and profitability due to strong customer demand. I will provide more commentary momentarily.
But first, please note that all financial results we discuss today are non-GAAP financial measures, 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 the results for the quarter. Calculated current billings, defined as the change in current deferred revenue, plus revenue recognized in the quarter, grew 23% year-over-year to $238.9 million and benefited from strength in vulnerability management and continued momentum of Tenable One, our exposure management platform.

Underpinning our better-than-expected top line results is strong customer demand. Specifically, we added 571 new enterprise platform customers and 140 net new 6-figure customers in Q4. While both metrics are exceptional, large deals, in particular, grew 40% year-over-year. The takeaway here is the investments we’ve made over the years to build a vast ecosystem of partners and extend our global reach allow us to effectively serve customers of all sizes in most major markets for traditional VM or increasingly for unified risk and exposure management.

Our Tenable One platform also creates a compelling upsell path for our customers and is benefiting our dollar-based net expansion rate, which remained strong and was 117% in the quarter. While this expansion rate may fluctuate on a quarterly basis, we generally expect it to be within a 110% to 120% range.

Revenue was $184.6 million, which represents 24% year-over-year growth. Revenue in the quarter exceeded the midpoint of our guided range by $3.6 million. Visibility remains strong as our percentage of recurring revenue was 95%, which is consistent with prior periods. I’ll now turn to expenses, where we are demonstrating notable operating leverage while also continuing to prioritize investments in growth and innovation.

I’ll start with gross margin, which was 78.5%, a decrease from 81% last quarter. Gross margin for the full year was 80%. As anticipated, cost of revenue increased sequentially, primarily due to higher demand for our cloud-based products, including Tenable One, which was launched in the fourth quarter and includes attack path analysis and external attack surface management.

Looking ahead, we expect gross margins for the full year 2023 to be in the high 70% range, with modestly improving margins throughout the year as adoption of Tenable One increases and we absorb the initial costs related to our newer exposure management offerings.

Sales and marketing expense was $78.3 million, which was up from $74.5 million last quarter. Sales and marketing expense as a percentage of revenue was 42% compared to 43% last quarter, reflecting greater efficiency in our go-to-market efforts. Sales and marketing expense reflects higher personnel costs, including payroll taxes as well as higher sales commissions and variable compensation attributed to our strong sales performance and higher renewal base in the quarter. For the full year, sales and marketing expense as a percentage of revenue was 44%.

R&D expense was $28.7 million, which was up from $27.4 million last quarter. R&D expense as a percentage of revenue was 16% this quarter and last quarter. R&D expense increased sequentially primarily due to lower capitalized software development costs in Q4, subsequent to the launch of Tenable One. For the full year, R&D expense as a percentage of revenue was 16%.

G&A expense was $17.9 million, which was up from $16.7 million last quarter. As a percentage of revenue, G&A expense was 10% this quarter and last quarter as well as for the full year. We will continue to make investments in G&A to support the growth and scale of our business. Income from operations was $19.9 million, $4.4 million above the midpoint of our guidance range due to the better-than-expected [top line] results and greater operational efficiency in our business. Operating margin for the quarter was 11%, which was 220 basis points better than the midpoint of our guidance.

Operating margin for the year was 10%. The takeaway here is, even in a dynamic environment, we’ve been able to efficiently invest for growth and expand our operating margins by leveraging our VM market leadership, sizable customer base and broad exposure management platform.

In terms of headcount, we ended the year with 1,900 employees, which reflects a 2% reduction in force in the fourth quarter, resulting in $1.8 million of severance. By aligning our cost structure more closely with our investment priorities, we believe we are well positioned as we enter 2023 to capitalize on the opportunities in front of us. All of this resulted in EPS in the fourth quarter of $0.12, which was approximately $0.05 better than the midpoint of our guided range.
Now let's turn to the balance sheet. We finished the quarter with $567.4 million in cash and short-term investments. Accounts receivable was $187.3 million and total deferred revenue was $664.6 million, including $502.1 million of current deferred revenue, which gives us a lot of visibility into revenue over the next 12 months.

We generated $32.1 million of unlevered free cash flow during the quarter and $128.1 million for the full year, which is up from $95.2 million last year. With 95% recurring revenue, high gross margins and high renewal rates, we feel confident that we can continue to generate attractive levels of cash flow while continuing to invest in the business. I will discuss cash flow in greater detail momentarily.

With the results of the quarter behind us, I'd like to discuss our outlook for the first quarter and full year 2023. For the first quarter, we currently expect revenue to be in the range of $186 million to $188 million; non-GAAP income from operations to be in the range of $9 million to $10 million; non-GAAP net income to be in the range of $3 million to $4 million, assuming interest expense of $7.5 million and a provision for income taxes of $2.1 million; and non-GAAP diluted earnings per share to be in the range of $0.02 to $0.03, assuming 120 million fully diluted weighted average shares outstanding.

And for the full year, we currently expect calculated current billings to be in the range of $915 million to $925 million, revenue to be in the range of $800 million to $810 million, non-GAAP income from operations to be in the range of $86 million to $91 million, non-GAAP net income to be in the range of $63 million to $68 million, assuming interest expense of $31.3 million and a provision for income taxes of $9.3 million. Non-GAAP diluted earnings per share to be in the range of $0.52 to $0.56, assuming 122 million fully diluted weighted average shares outstanding; and unlevered free cash flow to be in the range of $175 million to $180 million.

There are a few comments I want to make today that will provide important context to our guidance. First, we're delighted with our results for the quarter, which gives us a lot of confidence heading into 2023. We're beating the top and bottom line, added hundreds of new customers and closed a record number of large deals in one of the most highly dynamic markets we've seen in many years.

Our unified exposure platform, Tenable One, provides the security analytics and insights to help customers effectively assess risks across the enterprise by building better [interlock] across siloed security functions at a time when security teams are being asked to do more with less resources. And while pipeline continues to build, we are mindful of the current spending environment.

Accordingly, our initial CCB guidance for the year reflects 18% to 19% growth, which we believe is appropriately cautious, given the macro uncertainty. In terms of quarterly flow, we expect modest and lower year-over-year growth in the first half of the year due to our strong quarterly compares last year, with modestly higher growth in the second half.

In terms of profitability, we expect income from operations for the full year to grow approximately 30%, reflecting an 11% margin. We also expect to follow the same seasonal spending patterns as prior years, with incremental investment (technical difficulty) and higher operating margins in the second half of the year. We're also excited to be hosting a live in-person sales kickoff in Q1 for the first time since the pandemic, which is a discrete expense that is reflected in our Q1 guide.

With regard to cash flow, our unlevered free cash flow guidance for the full year represents 40% growth, resulting in a 22% margin, which is up from 19% last year. We expect unlevered free cash flow margin to generally ramp throughout the year, with Q3 as our typical seasonal high point. We're very pleased to provide an annual guide for unlevered free cash flow today. But please note that we do not plan to update our guide quarterly as the timing of collections and payments can vary from quarter-to-quarter.

Our next update is expected to be midyear on our Q2 call. One final parting comment on cash flow. The strength of our business model enables us to generate this type of improvement while continuing to make strategic investments in innovation and go-to-market. We delivered better-than-expected unlevered free cash flow in Q4. We are providing strong guide, an initial guide, that is, to the year, and we are well on our way to achieving the $240 million to $250 million target for 2024.
In summary, we have a lot of confidence in our ability to effectively grow and scale our business and drive higher levels of cash flow. At this point, I'd like to turn the call back over to Amit for some closing comments.

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

Thanks, Steve. We're very confident in our differentiated technology, our future and our ability to deliver exceptional results even in a tough market. We hope to see many of you at the Morgan Stanley conference in the upcoming weeks. We'd now like to open the call up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Hamza Fodderwala with Morgan Stanley.

Matthew Louis Saltzman - Morgan Stanley, Research Division - Research Associate

It's Matt Saltzman on for Hamza. Just wanted to hit on pipeline for the year ahead. Obviously, you've had a difficult macro situation. There's been some unevenness over last year in terms of deals closing on time, deals getting pushed. I'm just curious, what you guys are seeing kind of for the year ahead? And then also, just any incremental commentary you guys can provide around the federal opportunity (inaudible).

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

Thanks. We're generally pleased with pipeline. I feel like we've gotten a pretty good rhythm, good understanding of customer buying behaviors over the last several quarters and able to invest where we see continued opportunities. So prioritization of VM, especially in the enterprise market, and candidly, our ability to move enterprise customers through the Tenable One motions as well. So feel good about pipe.

In terms of the federal space, I'd say, it's very consistent with previous years in terms of seasonality. So weighted in what's typically the third quarter, but we feel good about the momentum that we're building and the pipeline that we're building throughout the year, especially in the state and local markets as well.

Operator

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

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

Great quarter, Amit. I just want to drill down a little bit on Tenable One, massive new product cycle. Love to understand how customers are thinking about the attack surface management?

And also, talk about the price uplift. You've mentioned previously, 30% plus. Love to just understand a little bit more detail about how that's -- the go-to-market structure. I know you're doing that sales kickoff this year. So '23 could be a really good year for that. But any color you can provide would be really helpful.
Amit Yoran, Tenable Holdings, Inc. - Chairman, President & CEO

Yes. I think, directionally, still looking at that 70%. So we haven’t updated that figure, but directionally, consistent with what we’ve seen previously with Tenable One.

And I’d say, both the sales team and the customer base seems to be gravitating to it. It’s a double-digit percentage of new sales and increasing high single-digit percentage of existing customers now on Tenable One. I think the message resonates. It makes sense.

They can look at a more complete understanding of cyber exposure, a more complete perspective of risk, a much more compelling set of analytics, including attack path analytics and asset inventory types of things, which they haven’t historically gotten with the vulnerability management program.

The other piece is it allows us to do spend and vendor consolidation. So by increasing their Tenable One spend to cover not only traditional VM, but also look at a cloud-based assets or also looking at their identity, we can offer them some volume-based pricing, which ends up being much more attractive than going to one vendor for VM, going to another vendor for external attack surface management, going to another vendor for cloud security. So we’re seeing great leverage in go-to-market function, and it really has been resonating with customers. We expect that trend to continue, if not accelerate.

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

And Joel, this is Steve. As a matter of clarity, the uplift we’re getting on Tenable One, we said in the past, it’s 70%, this quarter was no different. So we’re getting a substantial uplift. We’re transacting larger deals. It’s one of the reasons why we’re having great success adding lots of large customers.

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

Great. And just one quick follow-up, Steve, just -- or Amit. OT is obviously a very big opportunity. I think -- I know we’re early days, but -- and it feels for me to be greenfield. Can you just go through the competitive dynamics in some of these OT deals? And what inning are we in with regard to this OT opportunity?

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

Yes. I’d say, we’re probably still -- we’re probably in the second inning at this point. If you rewind the clock a couple of years as questions would come up about OT, what we’d say is we’ve entered some small procurements.

We’ve entered a pilot or Phase 1 deployments, where they’re looking at a couple of factories, a couple of facilities, trying to operationalize the data and the workflows that come along with the OT product. And over the last a couple of quarters, what we’ve said is we’re seeing some follow-on deals, global types of deployments, 6- and 7-figure types of transactions. So we’re seeing that momentum build. I think we’re still early in the market, and it’s a market that doesn’t move as fast as the IT market, but it’s very deliberate, and I think the spending is very real.

In terms of competitive dynamics and competitive landscape, I’d say we’re predominantly competing against just a small number, 2 or 3 private pure-play-focused vendors in the OT space. We feel like our technology is compelling and really leads the market, when it comes to looking at the converged IT/OT environment.

So if you look at a factory floor today or if you look at pipeline operations or other OT environments, they are not exclusively OT. They have a bunch of IT systems, IT control systems in those factory floors as well. And so we’re, I think, unique in our ability to deliver incredible insight for overall risk of facility, which would include both OT and IT. And we think it’s a significant competitive advantage for us.
Operator

Our next question comes from the line of Brian Essex with JPMorgan.

Brian Essex

Maybe, Amit, just to kind of follow up on spending environment. Any incremental color you can -- or additional color you can provide in terms of maybe how you've seen customers react to macro headwinds in the past? And what's different now? Do they tend to maybe approach asset coverage a different way? And does that maybe impact your ability to expand on the asset coverage side? And maybe how is it -- are you seeing adoption of Tenable One and EP? Does that insulate you somewhat from that kind of environment? Maybe if you could kind of touch on that a bit.

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

Yes, Brian, great question. We had a very successful quarter from an expansion business perspective, from a net dollar expansion business perspective.

So we are seeing customers expand both the number of assets we're covering for them as well as through Tenable One, in particular, seeing the different types of assets, where they're allocating licenses to more cloud security, identity or other areas where we had smaller presence in previous periods.

I think the sales team has gotten into a pretty good rhythm in terms of identifying -- how to identify opportunities, how to hunt through the budget and identify the new workflows in customer environments that are required in order to transact business.

If you rewind the clock 3 quarters or so, we said, "Hey, we're seeing elongation of sales cycles. We're implementing more rigorous inspection, nitpick processes across our sales forecasting." And I think those are paying off. I think the sales team feels more confident in transacting business in this environment, tougher macro, and it's just the reality we're operating in. But I think we feel pretty good about both pipe and our ability to close transactions.

Operator

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

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

Great. Could you speak to just how the quarter progressed, I guess, from a linearity standpoint? And to that end, Steve, maybe anecdotes around the different puts and takes regarding conservatism on the '23 numbers, just what you discounted, what you took into effect there?

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

Rob, good questions there. First, I would say, we had a strong finish to the quarter. We closed a lot of deals in December and -- especially the last couple of weeks.

That's said, our quarters continue to be very back-end loaded more so than what we typically see. I believe this is a consequence of the macro as customers continue to scrutinize budgets and evaluate spending priorities. We think cyber exposure fairs pretty well in this market. But increasingly, customers are waiting to see how their quarters play out before committing to a purchase.
So I think the takeaway here is that linearity is certainly a little more back-end loaded now than what we’ve seen in prior quarters. And in terms of our guide, our CCB guide, as we head into 2023, first, we have a much tougher compare, particularly in Q1, where we grew CCB 31% last year. We’re assuming the macro will continue to be challenging and potentially even deteriorate further, and that’s reflected in our guide.

But overall, I think we’re pleased with the progress on the quarter, adding lots of new customers, adding lots of large customers, pipeline levels are healthy. But I think we’re trying to take a cautious approach here. As we said, guidance is initially out of the gate. And obviously, there’s a lot of selling up in the year, and we’re encouraged with our progress to date, and we’ll have to see how the rest of the year plays out. But we feel very good about our business and have a lot of confidence in our ability to be successful in this dynamic environment.

Operator

Our next question comes from the line of Andrew Nowinski with Wells Fargo.

Justin Micahel Donati - Wells Fargo Securities, LLC, Research Division - Associate Analyst

This is Justin Donati on for Andrew. So congrats on a good quarter. When you were talking about the pipeline, you specifically spoke about strength with your enterprise customers. Just wondering if you’re seeing any difference in terms of buying behavior between your mid-market customers versus your enterprise customers.

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

No. I think we saw strength pretty much across the board, including in the mid-market customers as well. If anything, on the enterprise side, maybe just slightly smaller in the net new lands but continued health in the number of new lands and the expands and certainly strength in the mid-market as well.

Justin Micahel Donati - Wells Fargo Securities, LLC, Research Division - Associate Analyst

Great. And then just as a quick follow-up. You talked about your continued investments in your go-to-market. Just wondering what your plans are for sales hires in the coming year and if you’re expecting that to be more front-end loaded. Or you’re taking a slightly more conservative approach this year?

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

Well, first and foremost, we are planning to hire in 2023. And I think it’s fair to say -- adding more quota capacity. Our expectation is that we’re going to add more quota capacity in ’23 than we did in ’22.

We have a lot of confidence in our business. And investments are certainly a big part of that and obviously continue to double down on innovation and invest in product as well. We’ve been very active from a product perspective in bringing new products to market. .

We did talk a little bit about on the call the factors that kind of influence the timing of those investments. First is hiring. We tend to front load our hiring early in the year. So more of the hires will come online in the first half of the year and specifically with Q1. We also have a number of industry and other events in the first half of the year, such as our annual sales kickoff, which will be live in-person event this year, RSA and many others.

So clearly making a lot of investments. We’re very pleased to be offering the guide in terms of operating margin and cash flow that we’re providing today, and we have a lot of confidence in our ability to continue to drive further margin leverage.
Operator

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

Michael Joseph Cikos - Needham & Company, LLC, Research Division - Senior Analyst

I did want to touch on the customer behavior. I know you answered some earlier questions with respect to enterprise versus mid-market and obviously, the strong expansion we've spoken to. But for sales cycles, and that's really what I'm driving out here with the customer behavior, have they been relatively stable versus what we spoke about in Q3?

Or have we seen any elongation in any way on that front? And maybe it would be helpful, too, if you could kind of pepper in any color when thinking about geographic theater.

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

Mike, great to hear from you. We have not seen any elongation or any significant change in the sales cycle since what we spoke about in Q3 of last year. And I think that allows our sales team to just have continued confidence in their adjusted sales processes and forecasting methodology.

In terms of geos, I think, last year, we called out some -- any peculiar behaviors in geos. At this point, I think we're seeing fairly consistent performance across all major theaters in geos.

Michael Joseph Cikos - Needham & Company, LLC, Research Division - Senior Analyst

That's great. And one more, if I could. But I did just want to ask about Q1, just given the fact that we're almost halfway through it already. Can you provide any additional color for how customers have put together their cybersecurity budgets as we think about calendar '23?

Obviously, we're all talking about the increased scrutiny here. But curious, since cyber is perceived as being this more insulated sector, what are those customer conversations been like? And just a real quick housekeeping to tap on to the end of that. But Steve, I know you spoke about the annual sales kickoff in Q1 as being in-person.

Is there any way to quantify how much of an expense that item is? Are we talking about an incremental $2 million to $3 million? Or -- any color on both those fronts would be beneficial.

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

Yes. I'll provide a little bit of color here on both your questions, and I think Amit will interject with maybe some color commentary on customer spending and budgets for '23.

First, with regard to -- I think your question was like how does it look here out of the gate. We're encouraged by what we saw in January. I'm very encouraged but that's reflected in our outlook today, and obviously, March will be determinative, given typical monthly flow for us. The other thing I'll say with regard to sales kickoff, the quantum of that investment is much larger than $2 million. We're talking north of $5 million. So it's a large discrete item.

We're very pleased to be doing a live in-person sales kickoff this year for the first time since the pandemic, and our sales team is really excited about it as well as our -- the rest of our company. Obviously, it's factored in our guidance. And our guidance, we believe, is strong out of the gate, with regard to margins and cash flow. And our expectation is that operating margins will improve throughout the year, consistent with what we've seen in prior years.
Amit Yoran - Tenable Holdings, Inc. - Chairman, President & CEO

Yes. I think the only thing I would add to it is that the VM market remains very healthy. We see customers continuing to expand their VM coverage. And we’re also seeing great traction, especially with Tenable One, around cloud security. We called out strength in our OT sales during the course of the quarter.

So customer budgets are there, I think, to the extent that we can become a cost-effective vendor consolidation platform play for them. There’s a lot of interest, a lot of strategic dialogue around that. And I think customers are very excited about some of the newer analytics that we’ve introduced with Tenable One.

So we look forward to updating you during the course of the year. But I feel like Tenable One, looks like it will continue to play a larger and larger factor throughout the year and going into next year.

Michael Joseph Cikos - Needham & Company, LLC, Research Division - Senior Analyst

That’s great to hear. Good to see the profitability guide and the reiterated unlevered free cash flow guide when we think about calendar ’24 as well. I’ll turn it over to my colleagues.

Operator

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

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

Okay. Great. Amit, maybe just to start with you, and apologies if this has already been addressed, but I was wondering if you could just talk about how customers look at the ROI from a platform like Tenable One.

It includes so much more kind of additional valuable product that lowers the risk profile. But I’m curious, when you talk to customers about Tenable One, how are they sort of thinking about ROI?

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

Great question. There’s a couple of obvious and a couple of nonobvious answers to it. I think the most obvious is just from a vendor consolidation cost reduction standpoint.

So if you’re using Tenable for VM, let’s say, a random example, you have 30,000 assets and now you want to look -- also look at your cloud security requirements, your Active Directory requirements, if you’re going to a separate vendor, for those solutions, you’re spending -- you need 1 through 10,000 on cloud assets and 1 through 8,000 on Active Directory, in addition to the 1 through 30,000 on VMwares.

If you’re consolidating your spend with Tenable and Tenable One, you can buy at volume discount, it’s 1 through 50,000 on Tenable One. And so the leverage in budget and spend through vendor consolidation is very meaningful, which in today’s macro environment and what’s happening with scrutinizer budget, we think is compelling differentiation for us.

The second is in the analytics. We simply are able to bring more analytics and unified analytics to the table than going to disparate vendors. So for instance, building an asset inventory everywhere, a particular piece of software exists across your environment, anywhere vulnerability exists across your environment, whether it’s on-prem, in cloud or other places, we think, is very compelling. Prioritizing what needs to be addressed, we think, can be a compelling differentiation.
Looking at a [top-top] analytics to say, "Hey, what is the path -- what are the various paths of systems and vulnerabilities and users and permissions that could get me to this sensitive internal asset from my external attack surface from Internet-facing assets?" is a pretty compelling differentiator compared to buying individual and stove type solutions.

So we think both from a value and analytics standpoint as well as a vendor and cost consolidation standpoint, the platform approach to understanding the exposure and risk just makes sense. And that’s why we’re seeing both the sales team and customers really gravitate toward it.

Saket Kalia - Barclays Bank PLC, Research Division - Senior Analyst
Got it. Got it. That makes a lot of sense. Steve, maybe for my follow-up for you. Again, apologies if this was talked about, but can we just talk a little bit about gross margins for ‘23 that was down sequentially in Q4? I’m guessing that’s from hosting costs. But curious, how you think about that here in ’23 as Tenable One presumably becomes a bigger part of the business?

Stephen A. Vintz - Tenable Holdings, Inc. - CFO
Sure. Great question, Saket. The gross margin in the fourth quarter came in as expected and is impacted by the recent launch of some new products for us. One is ASM, which is a new use case. The cost of domain attribution is something we can leverage over time as we see higher penetration rates.

Also, with Tenable One, we have a more robust cyber asset inventory, which is critical to supporting functionality such as attack path analysis and Lumin exposure view.

So these are new areas of innovation come with some initial semi-fixed costs that we expect to fully absorb over time. And that’s certainly impacting gross margins. Overall, very pleased with gross margins, and we’ve said on the call that we expect gross margins to kind of stay in the high 70% range for 2023, and we expect gross margins to improve during the course of the year.

Operator
(Operator Instructions) Our next question comes from the line of Mike Walkley with Canaccord Genuity.

Thomas Michael Walkley - Canaccord Genuity Corp., Research Division - MD & Senior Equity Analyst
Congratulations also on the strong close to the year. Amit, when you study your customer base, what percent do you believe will ultimately upgrade to Tenable One, while it’s high single digits of the base currently, where could that penetration go over the next couple of years had that should be a strong source of sustained growth?

Amit Yoran - Tenable Holdings, Inc. - Chairman, President & CEO
Yes, it’s a great question. And I think, obviously, there’s tremendous potential. We're putting a lot of focus on it as a company. The leading indicator for that would be our new sales. And what we’re seeing is high teens percentage of new sales coming in on Tenable One.

So over time, as long as that continues to remain healthy, we would see a larger and larger percentage of customers moving to Tenable One. Where it could go long term, remains to be seen, but we’re pretty excited about the potential.
Thomas Michael Walkley - Canaccord Genuity Corp., Research Division - MD & Senior Equity Analyst

Okay. Great. And just a quick follow-up question. Any changes in the competitive environment entering 2023, when your competitors potentially putting themselves up for sale? And you guys certainly have a lot of momentum with Tenable One. Just any change in the competitive environment that seems more favorable as you enter ‘23?

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

Yes. I mean, obviously, we wouldn’t speculate about that, but I feel really good about the competitive environment. We are pretty consistent in saying that we have exceptionally strong win rates, especially in this market against our primary competitors. That remains -- those win rates remain exceptionally strong.

And while we don’t have a specific update to that, I’d say anecdotally, continues to climb in -- the sales team feels exceptionally confident going into any VM opportunity, that those are really ours to lose. And candidly, they feel like Tenable One gives them a very significant value-differentiated capability to talk about as well.

Operator

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 & Partner

And let me echo my congratulations as well. I wanted to maybe dig in a little bit into the Active Directory and identity products. Can you talk a little bit about what you’re seeing in terms of demand there and maybe the potential for that to be a larger product set over time as well?

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

Well, we think it’s -- there’s tremendous market potential there. As you know, Jonathan, Active Directory is target #1 for hackers, whether it’s a nation state adversary as we saw on the Mandiant breach or whether it’s ransomware, where over 90% of ransomware is going directly after domain controllers and Active Directory.

Active Directory is a trick and mess to deploy in any large environment and almost impossible to keep clean when you look at the number of pieces of software and the complexity of Active Directory, the number of pieces of software we should modify as they get installed into an enterprise environments. So having a solution -- and most organizations don’t have a solution in this area. The security teams know it’s a big problem.

They maybe do a consultant and an annual audit or assessment of their Active Directory environments, which is clearly not enough. So we feel like there’s tremendous market opportunity. The sales team has a lot of confidence in the Active Directory product and bringing it into customers. We had a great quarter with Active Directory in Q4. So excited about the potential, both in 2023 as well as Active Directory playing an increasingly large role in Tenable One and some of the analytics that we’re unlocking with Active Directory and identities.

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

Great. And just as a follow-up for Steve. I think there was a small reduction in force. Can you maybe give us a little bit more detail on the risk and maybe what that means in terms of your margins, maybe where some of the cuts came from?
Stephen A. Vintz - Tenable Holdings, Inc. - CFO
Yes. It was fairly broad across many functional departments, really with an eye towards the improving operational efficiency and better aligning our cost base with the market opportunity that’s in front of us.

And we feel like we’re in a great position this year to make investments, as Amit talked about earlier, making investments in terms of product and adding lots of quota capacity. And then one of the comments I made earlier was our expectation is that we’re going to have more quota capacity in ’23 than we did in 2022. Obviously, the demand environment remains highly dynamic, but we’ve done a good job over the years balancing growth with profitability, driving margin leverage and achieving sustainable levels of growth.

Operator
Our next question comes from the line of Joshua Tilton with Wolfe Research.

Joshua Alexander Tilton - Wolfe Research, LLC - Research Analyst
My first one is kind of high level. But the feedback from the channel, I guess, throughout last year on VM, I would say, has gotten incrementally worse each quarter. But if we look at your guys results, it sounds like you guys have almost gotten incrementally better, especially in regards to your 6-figure adds. Could you maybe kind of just help us reconcile those data points?

Amit Yoran - Tenable Holdings, Inc. - Chairman, President & CEO
Yes. In terms of the channel checks, we don’t -- I think this for you, we don’t see it. Our channel partners remain very bullish on VM and very bullish about their ability to differentiate Tenable as the leading VM vendor and provider and feel bullish that their customers are looking to expand their VM capabilities and more -- as more and more executive questions are asked of security programs.

Are we vulnerable, where are we vulnerable, are we exercising good standard of care? Are we patching our systems quickly enough? Are we being negligent, I think those -- answering those types of executive questions really comes from your VM program, not from your firewall, not from your endpoint or your logging solution.

So as more executives are asking questions of cyber, we feel like it bodes well for VM. We’re seeing that in our results. We’re seeing that in our conversations with customers. And Tenable One allows us to have even more strategic conversations across a broader set of asset types.

So we’ve remain committed to the VM and Cyber Exposure market. And I think given both our results and our confidence in what we’re seeing in our own conversations with customers and channel partners, we will remain committed to and increasingly invest in that strategy.

Stephen A. Vintz - Tenable Holdings, Inc. - CFO
Yes. And the one thing that I’ll add is, keep in mind that we transact sales in 160 countries. We have hundreds of channel partners and -- so I can’t speak to the channel checks, but sometimes if you’re talking to a partner or a contact, that may only have a very specific view into our business or maybe even to the VM market. And also, our exposure solutions collectively represent about 50% of our total sales.

So over the years, we’ve done a really good job becoming more strategically relevant to our customers, broadening the focus. And we’re having success selling a platform and playing in larger market opportunities such as cloud security and even identity and security analytics, which are top spending priorities and pain points for our customers this year.
Joshua Alexander Tilton - Wolfe Research, LLC - Research Analyst

Makes sense. And then just a quick follow-up. It sounds like you guys are definitely communicating that the initial CCB guidance for ’23 is, in your opinion, de-risked. I think you talked about that it assumes the macro actually gets worse. Is there anything else outside of that, that you can just quantify or take one level deeper in terms of what exactly inside the guide is more derisked? Maybe expansion versus new business, where you expect NRR to kind of shake out? Anything else you can kind of talk to in the ’23 guide that should help us feel like those numbers are derisked?

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

Yes. We think our CCB guide for the year is good, but we described it as cautious. And we think that’s the right approach to have in a market like this, the [Tisty] dynamic, right? Each quarter is different in its own right. And our expectation going into 2023 is that the macro will remain challenged and perhaps will even worsen the first half of the year.

So we want to be prepared for whatever comes our way. We’ve done a good job over the past several quarters, really identifying opportunities where we have success, larger -- closing larger deals and some verticals are stronger than others, as we’ve talked about earlier, and tech was particularly strong for us, financial services, all of those.

So we have a good sense of what’s working really well for us. I think with regard to the guide, I think we’re just taking a more cautious approach, and we’re assuming that the macro could potentially impact close rates. And maybe even renewal rates. But what I will say is that our renewal rates continue remain strong. Upsell was very strong in the quarter. We did add lots of large deals. But our expectation is that new lands for new logos could be tougher to transact in ’23.

Operator

Our next question comes from the line of Rudy Kessinger with D.A. Davidson.

Rudy Grayson Kessinger - D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst

Certainly, a lot of talk about Tenable One and good traction there. I think it was last quarter, maybe the quarter before you guys started talking about the salesforce really leading with that product as opposed to leading with VM. Just where are we in that evolution? I don’t know if you can speak to maybe the percent of deals or cycles where your reps are leading with Tenable One as opposed to VM. But just how has that changed over the last 6 months?

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

Yes. I think the sales team has a lot of confidence in the product, seeing the customer traction and the results that customers are experiencing with Tenable One gives them an increasing level of confidence. Today, it remains a teens percentage of new sales. But obviously, in the pipeline -- pipeline is more heavily weighted towards Tenable One, and we expect that to continue to accelerate with sales kickoff and more training and more time and more differentiation.

Rudy Grayson Kessinger - D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst

Got it. And then secondly, you talked about vendor consolidation playing out as a positive for you guys. I guess I’m also curious, there are some other kind of larger, broader cyber platforms out there that have grown in a VM product in the mix over the last couple of years. I’m curious if you’re seeing vendor consolidation maybe hurt you in some cycles with some of those larger platforms out there throwing in the VM product.
Amit Yoran - Tenable Holdings, Inc. - Chairman, President & CEO

Yes. There’s been a lot of vendors over the course of years, making a lot of noise about VM, going back 4, 5-plus years, Tanium, CrowdStrike, Microsoft others. And what I would tell you is they make noise. We see them for a quarter or 2 and then very quickly their sales team understand that their products are inferior and they start gravitating to their core markets and candidly, where their companies are investing much more aggressively logging, SIM and elsewhere.

So especially in a product like VM where independent audit is an important function and where we feel like we’ve got a quantitatively and qualitatively differentiated product and experience and understanding the enterprise, we almost never see those larger IT vendors participating and certainly never see them beyond a rule -- a first phase of competition.

I guess the only other thing I would add to that is obviously, our footprint is broader than VM. So if customers are really looking to understand cyber is more broadly than even other solutions which offer VM capability are not really competitive. And our Cyber Exposure solutions now represent, as Steve said, 50% of our sales.

Operator

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

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

Yes. So were there any call-outs on the geo side? EMEA, for example, growth here was decelerating in the last 2 quarters. You have a tough comp in Q1 in EMEA as well. Just any callouts on the geo side.

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

No. I think, on the geo side, what we just said earlier is that all theaters performed pretty much to expectations in both enterprise and commercial segments. So felt good about the international markets and the balance of our international performance.

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

Okay. And separately, you had a 2% headcount reduction in Q4, but -- and I think you said 1,900 employees for the end of the year. I think that’s up 10% or so year-to-year. What’s your expectation for a headcount growth and be quota-carrying salesperson growth in ’23?

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

Sure. Well, we provide headcount at year-end following our Q4 results. So -- this is not a number we provide for the upcoming year as part of our annual guidance. But as we discussed earlier, we are hiring, and we’re planning to make investments, most notably in product and go-to-market. In terms of quota capacity, we expect to add more quota capacity in 2023 than we did in 2022. Unequivocally, we have a lot of confidence based on the results of not only this quarter but the past couple of quarters. So we’re adding lots of customers transacting lots of large deals.

The takeaway here is the business climate is pretty fluid. And so we’re constantly reassessing the investment priorities. But as we discussed earlier, we’re going to add headcount. Look, we’re in the fortunate position to make these investments in ’23 because we grew our workforce very thoughtfully since the pandemic. Our workforce grew, in total, 28% over the last 3 years, which puts us in a great position to invest this year while still delivering margin improvement. So we think we’re doing a good job aligning our cost base with the investment opportunities that are in front of us.
And ladies and gentlemen, we have reached the end of the question-and-answer session. And this also concludes today’s conference, and you may disconnect your lines at this time. Thank you, and have a good day.