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Appian Q3 2023 Earnings Call Prepared Remarks Transcript

Sri Anantha

Thank you, Operator. Good afternoon and thank you for joining us to review Appian's third quarter 2023 financial results. With me today are Matt Calkins, Chairman and Chief Executive Officer and Mark Matheos, Chief Financial Officer. After prepared remarks, we'll open the call for questions. Today, you'll want to follow along with our earnings presentation. You can download it from the main page of our investor site at investors.appian.com.

During this call we may make statements related to our business that are forward-looking under federal securities laws and are made pursuant to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. These include comments related to our financial results; trends and guidance for the fourth quarter and full year 2023; the benefits of our platform, industry, and market trends; our go-to-market and growth strategy; our market opportunity and ability to expand our leadership position; our ability to maintain and upsell existing customers; and our ability to acquire new customers. The words "anticipate," "continue," "estimate," "expect," "intend," "will," and similar expressions are intended to identify forward-looking statements or similar indications of future expectations. These statements reflect our views only as of today. They do not represent our views as of any subsequent date. They are subject to a variety of risks and uncertainties that could cause actual results to differ materially from expectations.

For a discussion of the material risks and other important factors that could affect our actual results, refer to our 2022 10-K, our 10-Q filings for 2023, our 8-K filings, and other periodic filings with the SEC. These documents are also available on our "Investors" section of our website.

Additionally, non-GAAP financial measures will be discussed on this conference call. Refer to the tables in our earnings release and the investor section of our website for a reconciliation of these measures to their most directly comparable GAAP financial measures.

With that, I'd like to turn the call to our CEO, Matt Calkins. Matt?

Matt Calkins

Thanks Sri and thank you everyone for joining us today.

In the third quarter of 2023, Appian's cloud subscription revenue grew 27% year-over-year to $77.2 million. Subscriptions revenue grew by 20% to $103.8 million. Total revenue grew 16% year-over-year to $137.1 million. Our cloud subscription revenue retention rate was 117% as of September 30th. Our adjusted EBITDA was a loss of $(5.3) million.

A couple of financial call outs. Appian's non-GAAP gross margin was 75% this quarter, the highest it's been since our IPO. Our adjusted EBITDA was well above guidance. Don't read too much into this dramatic sequential improvement. It's largely due to the timing of our expenses. The takeaway should be that we delivered on last year's commitment to reduce adjusted EBITDA loss below 10%. We'll continue on our path to positive EBITDA – and I want to emphasize that this transition will not come at the expense of growth.

Last earnings call I spoke about Appian's approach to AI. As you may recall, we're pursuing something we call 'Private AI'. I don't believe that most customers will allow their data to be sent over the internet to a public AI service, nor do I think they wish to train an AI algorithm they do not own. Under Private AI, data stays entirely private -- and we also achieve better compliance, auditability, and security levels. Our Private AI offering depends upon our Data Fabric functionality, which is itself highly differentiated in the market. We have a data-centric approach to AI, and we think the data side of things has been somewhat under-recognized or underappreciated in all the hype around generative models. In Private AI, we feel we have a defensible and advantaged offering.

Over one-hundred customers used Appian AI in Q3. Here's an example: An Australian wealth fund manager processes inbound portfolio requests for tens of thousands of customers and brokers on our platform. The group receives requests through email. Before Appian, employees handled these emails, routed them to relevant parties, and opened cases to process the requests. In Q3, this firm trained a Private AI model from Appian with its own data. The model ingests emails, classifies them, and routes them to the appropriate person for follow-up. AI automates the intake-to-resolution process and eliminates the need for manual triaging. Now, the customer can resolve cases faster.

The AI market is still developing. It's too early to say which ideas and vendors will prevail. We're advocating this private data-centric approach to AI because we believe in it and also because we're getting strong support from buyers. AI won't be a winner-take-all game. Scores of different approaches will succeed by finding and satisfying specific markets. And it might yet be better to be agile than to be big. There's plenty of room for Appian. I'm optimistic about our future in AI.

Turning to our earnings presentation, you'll see our series of special metrics that provide additional transparency on how macroeconomic factors are impacting our business. These numbers again indicate that there continue to be some effects. I hope these extra reports have been useful in 2023. For next year, we'll consolidate them and probably add some new ones.

My favorite fact from the report packet is that Appian's count of seven-figure ARR customers has crossed 100 for the first time. This uptick coincided with some large deals in the US Public Sector. Here's some combined examples: My first case is a federal agency that manages procurement processes for the Department of Defense. The agency selected Appian two years ago to unify disparate contract writing systems. This quarter, it purchased a seven-figure software deal to license thousands more users. Now, Appian will manage end-to-end contract writing processes for tens of billions of dollars in contracts annually.

Another DoD group signed a seven-figure software deal in Q3 and became a new Appian customer. The group will manage law enforcement investigations in a secure, Impact Level 5 environment on Appian Government Cloud. Before, the agency manually conducted investigations using paperwork and offline channels. Now, over one thousand field agents and back-office employees will create cases, review evidence, and dispatch law enforcement support within a single Appian app.

As you know if you've heard this call in the past, I like the solutions business. I like it because the sales cycles are shorter, competition narrower, pricing power higher, and the addressable market (in total) larger. We're making progress on solutions this year.

Here's an example. A leading global investment manager increased its annual recurring spend on Appian software by 40% in Q3. The firm purchased our Customer Lifecycle Management solutions a few quarters ago when it became a new Appian customer. Our solutions automated manual processes so the company can onboard and manage clients faster. In Q3, it decided to add its legal department to the process and purchased additional platform licenses to build new workflows. For example, it will automate legal agreement processes so lawyers can readily collaborate on tasks and the company has real-time visibility on the contract's status.

Let me offer you a few marketing updates. Two to be precise. First, Randy Guard joined Appian as our new Chief Marketing Officer. He brings decades of experience leading marketing, product strategy, and technology teams. Second, we were named a leader in the Gartner Magic Quadrant for Enterprise Low-code Applications two weeks ago.

Before I hand the call over to Mark for a deeper look at our financials, I want to mention something. Looking past the numbers for a moment, the company is boiling with activity beneath the surface. Appian has made substantial investments in our platform over the past few years and introduced new features and solutions. We're realizing a data-centric AI offering. We're evolving our go-to-market activities and driving a new set of sales plays that will open new opportunity. Out of sight of the news and the numbers, we're working hard to prepare Appian for a strong future.

With that, I'll hand the call over to Mark.

Mark Matheos

Thanks, Matt. I'll review the financial highlights for the quarter, and then will provide guidance for Q4 and the full year, 2023.

Total revenue, cloud subscription revenue, adjusted EBITDA, and non-GAAP EPS were above guidance. We saw continued healthy contribution from existing customers and strong growth from key industry verticals, especially the US Public Sector and Financial Services.

Let's go into the details. Cloud subscription revenue was $77.2 million, an increase of 27% year-over-year, and above guidance. On a constant currency basis, cloud subscription revenue grew 24% year-over-year. Subscriptions revenue was $103.8 million, an increase of 20% year-over-year. On a constant currency basis, subscriptions revenue grew 17% year-over-year. Consistent with the prior quarter, subscriptions revenue growth was impacted in part by some customers converting to the cloud subscription model.

Professional services revenue was $33.3 million, an increase of 6% year-over-year. On a constant currency basis, professional services revenue grew 3% year-over-year. Our professional services will continue to be a strategic offering, focused on enabling partners and driving customer success; however, we expect professional services revenue to continue to decline as a percentage of total revenue.

Total revenue was $137.1 million, an increase of 16% year-over-year and above our guidance. On a constant currency basis, total revenue grew 13% year-over-year. Subscriptions revenue was 76% of total revenue, up from 73% in the prior quarter and year ago period.

Our cloud subscription revenue retention rate was 117% as of September 30, 2023, up from 115% in the prior quarter and year ago period. As a reminder, we continue to target a cloud subscription revenue retention rate of 110% to 120% on a quarterly basis.

Our international operations contributed 35% of total revenue, compared to 31% in the year ago period. On a year-over-year basis, international growth was broad-based and saw healthy contributions from both APAC and EMEA regions.

Our cloud software net new ACV bookings were approximately 80% of the total net new software bookings during the nine months ending September 30, 2023, compared to 85% in the first half of 2023 and 80% in 2022.

Now, I'll turn to our profitability metrics. Non-GAAP gross margin was 75%, compared to 73% in the prior quarter and year ago period. Subscriptions non-GAAP gross margin was 89%, consistent with the prior quarter and 90% in the year ago period. Professional services non-GAAP gross margin was 30%, compared to 28% in the prior quarter and 27% in the year ago period. We expect professional services non-GAAP gross margin to decline to the low to mid 20% range in 2023 and beyond. We continue to invest in non-billable resources to help our customers maximize the value of their Appian investment.

Total non-GAAP operating expenses were $110.5 million, relatively flat from the year ago period. We continue to make good progress on optimizing our cost structure. In the current uncertain macro environment, we are prioritizing projects that generate a higher ROI. In addition, we continue to scale our Chennai R&D center, which should help drive operating leverage long-term.

Adjusted EBITDA loss was $(5.3) million, versus our guidance of a loss between $(16.0) million and $(12.0) million, and compared to an adjusted EBITDA loss of $(22.9) million in the year ago period. The upside in EBITDA was driven by prudent OPEX discipline and pushout of some expenses into Q4. We remain confident about continued improvement in adjusted EBITDA margins going forward.

In the third quarter, we had approximately $4.3 million of foreign exchange losses, compared to $1.2 million of foreign exchange gains in the prior quarter and $6.1 million of foreign exchange losses in the same period a year ago. We don't forecast movements in FX rates, therefore they aren't considered in our guidance.

Non-GAAP net loss was $(14.7) million or $(0.20) cents per basic and diluted share, compared to non-GAAP net loss of $(30.9) million or $(0.43) cents per basic and diluted share for the third quarter of 2022. This is based on 73.2 million basic and diluted shares outstanding for the third quarter of 2023 and 72.5 million basic and diluted shares outstanding for the third quarter of 2022.

Turning to our balance sheet, as of September 30, 2023, cash and cash equivalents and investments were $169.5 million, compared with $196.0 million as of December 31, 2022. For the third quarter, cash used by operations was $(65.0) million versus $(43.7) million for the same period last year. The increase in cash usage was primarily due to a one-time payment of $57.3 million for the judgment preservation insurance policy, which I'll speak about in more detail later.

Total deferred revenue was $197.8 million as of September 30, 2023, an increase of 20% from the year ago period. As we have stated on past calls, the majority of our customers are invoiced on an annual upfront basis, but we also have some customers that are billed quarterly or monthly. Due to the variability of our billing terms, changes in our deferred revenue are generally not indicative of the momentum in our business.

We continue to believe cloud subscription revenue is a better indicator of our business momentum than billings or remaining performance obligations. The latter metrics fluctuate based on the timing of invoicing, seasonality of on-prem license revenue, and the duration of customer contracts. The true scale of the business is represented by subscriptions revenue, which includes support and all software subscription revenue regardless of whether the customer deploys to the Appian Cloud, their private cloud, or on-prem.

Before I turn to guidance, I want to touch on Appian's accounting for the Judgment Preservation Insurance (JPI) policy and the current macro environment. During the third quarter, Appian obtained a Judgment Preservation Insurance (JPI) policy. This agreement resulted in a one-time payment of $57.3 million. The payment was made from available cash on hand. From an income statement perspective, this payment will be amortized over approximately 3 years and will be excluded from adjusted EBITDA calculation. For additional details about the policy, please refer to our 8-k filing from early September.

We continue to be prudent with our guidance assumptions in the current macro and geopolitical environment. As noted on prior earnings calls, we continue to experience deal slippage, higher scrutiny of budgets, and elongation of sales cycles. In some instances, deals are being impacted by customer specific issues, such as executive changes, internal restructuring, and layoffs. Finally, we are being cautious with respect to our expectations for the federal vertical given the possibility of a government shutdown.

Now, I'll turn to guidance.

For the fourth quarter of 2023, cloud subscription revenue is expected to be between $78.6 and $79.6 million, representing year-over-year growth of 19% and 21%. Total revenue is expected to be between $138 and $143 million, representing year-over-year growth of 10% and 14%.

Adjusted EBITDA loss for the fourth quarter of 2023 is expected to be between $(16.1) and $(12.1) million. Non-GAAP net loss per share is expected to be between $(0.29) and $(0.24) cents. This assumes 73.3 million basic and diluted weighted average common shares outstanding.

For the full year 2023, cloud subscription revenue is expected to be between $300 and $301 million, representing year-over-year growth of 27%.

For the full year 2023, total revenue is expected to be between $538 and $543 million, representing year-over-year growth of 15% and 16%.

Adjusted EBITDA loss is expected to be between $(62) and $(58) million. Non-GAAP net loss per share is expected to be between $(1.13) and $(1.07). This assumes 73.1 million basic and diluted weighted average common shares outstanding.

Our Q4 guidance assumes the following:

- First, professional services revenue will decline at a high single digit rate compared to the year ago period.
- Second, on-prem license revenue will increase by a low double digit rate compared to the year ago period.
- Third, other non-operating expenses will be approximately $2.5 million in Q4.
- Fourth, capital expenditures will be approximately $2 million.
- Finally, our guidance assumes FX rates as of October 25th, 2023.

In summary, we are excited about the growth opportunities ahead of us. We remain focused on investing in areas that will drive growth and generate superior returns long-term.

With that, we'll turn it over to questions.