Q1 2023 Earnings Call Prepared Remarks

Sri Anantha

Thank you, Operator. Good afternoon and thank you for joining us to review Appian's first 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 second 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 filing for Q1 2023, 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 first quarter of 2023, Appian's cloud subscription revenue grew 31% year-over-year to $69.7 million. Overall subscriptions revenue almost broke the 100-million line but finished at $99.0 million. Total revenue grew 18% year-over-year to $135.2 million. Our cloud subscription revenue retention rate was 115% as of March 31. Our adjusted EBITDA was a loss of ($15.8) million. Our non-GAAP gross margin set a post-IPO record at 75%. These results exceeded our guidance.

We hosted our annual conference, Appian World, in San Diego last week. I'm pleased with the attendance and the enthusiasm. More than twice as many prospects came to Appian World this year as last.

Our conference theme was 'Process Automation'. Customers talked about the benefits of running the whole process lifecycle on Appian's platform.

On stage, I explained the emerging split between what I call 'public AI' and 'private AI'. Public AI involves sharing data with a cloud AI provider, and that's unacceptable to many of our clients. Companies want to keep control of their data -- they may have legal restrictions as well -- and they don't want to help train an algorithm that could then be used by their competitors. Private AI, by contrast, means every company cultivates their own AI algorithms, starting with a public model, but training it privately and using it privately.

I predict that in the long run, private AI 'wins', which is to say it becomes the more popular model for our customers. I think customized AI algorithms will someday be as normal as custom applications, inside big firms. Private AI will feature strong accuracy, despite having smaller training datasets, because the data is more pertinent, and the scope of each AI will be narrower. (These AI's won't write limericks or make images – they'll do just the one thing they're made for.)
Appian will facilitate both kinds of AI, but we prefer the private model. We announced some new features – which I call 'low-code AI' – that make it easy for customers to cultivate their own AI on Appian-connected datasets.

This public/private split separates Appian from its largest competition. By being a champion of private AI,

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we appeal to buyers who prefer not to share their data assets.

Our ability to assemble large datasets to train private AI algorithms comes from a feature called Data Fabric. 'Data fabric' is a fancy term for a virtual database, and it means that we can address data from across the enterprise like it was together, even though it remains apart. This strategy is preferable for our clients, who dislike having to relocate data. Data is the hardest part of building & running processes, so this feature constitutes a substantial advantage.

Our data fabric in turn gives us a critical edge at inventing the next generation of Process Mining. We call our new version "Process HQ", and we're starting a beta program for it next quarter. It uses Appian's capabilities to overcome the limitations of Process Mining as it exists today. (Process Mining projects are notorious for taking a lot of time to gather a data set, and not being immediately actionable.) In Process HQ, data collection can be quick, using Appian's data fabric. Recommendations for delegating work to new types of workers (like AI or RPA) can be instantly applied, using Appian's full suite of automation tools. Process HQ will quantify the efficiency gains made by Appian-run processes, at the same time as helping owners make further improvements.

All three of these critical advances are data-related. We see lasting advantage over competitors, and value for our clients, in our data capabilities.

For example, a leading European automotive manufacturer uses Appian to better leverage its data and boost productivity. The company currently automates supply chain processes with Appian, saving tens of millions of dollars annually. In Q1, it purchased a seven-figure software deal to build more apps and further optimize operations. One app will manage warranty claims. Appian will integrate the company's systems to run the end-to-end claims assessment and review process. Our platform will feed the customer's data into a machine learning model to predict which claims need intervention. The customer expects to improve operational efficiency of this process by 20% and save millions of dollars per year.

The US Public Sector contributed half of our Q1 new logo ACV, becoming one of our strongest growth areas. We recently announced some new advances for this market. First, Appian Cloud is now StateRAMP certified. This is the state-level cybersecurity equivalent of FedRAMP. It'll enhance our likelihood of winning deals with sensitive workloads. We also launched two new solutions for government customers: Contract Writing, for federal, and Constituent Case Management, for state & local. Contract Writing completes our Government Acquisition Management suite, our GAM suite, so customers can now run the entire acquisition lifecycle on Appian. Constituent Case Management is Appian's first solution for state and local customers. It's a flexible case management solution that governments can use to serve residents.

I'll share two Public Sector customer stories. First, a large US state government is under executive mandate to simplify its process for registering new businesses. In Q1, the government purchased a seven-figure Appian software deal and became a new customer. Appian will replace a decades-old business registration and ancillary filings system. Our platform will run the end-to-end process for establishing LLCs and renewing licenses for millions of entrepreneurs and growing businesses. We won this deal after a proof of concept proved the power of our platform with a comprehensive proof-of-concept that integrated the customer’s systems and leveraged our native AI and RPA capabilities.

A US international affairs agency also became a new Appian customer. Our platform will replace a series of old logistics management applications that are too costly to maintain. (They’ll begin with a vehicle fleet-management process and plan to follow with others.) These apps are core to the organization's mission and represent one of the largest IT spends on logistics management in the Federal government.

Partners continued to drive growth this quarter. For example, a partner helped us land a leading financial services and credit card provider as a new logo in Q1. One of the company’s largest business segments manages expenses for corporate clients and must monitor all client interactions in accordance with federal regulations. Appian will create a single tracking application that monitors relationships across the company’s various interaction channels, including voice, chat, and email. Before Appian, agents manually audited interactions because their systems were siloed. We won this competitive deal after our partner built a proof-of-concept in just three days.

Forrester, the analyst firm, is currently completing a commissioned Total Economic Impact study on Appian's customers. I shared the preliminary results last week at Appian World. This study finds that a composite organization comprised of Appian customers experienced a 90% reduction in development time, realized a positive return-on-investment in just six months, and a full ROI of 257% over three years, and accelerated process execution by a factor of 20 times. Good stuff.

These results explain why Appian prospects and customers purchase our software. Our quick return-on-investment appeals to the cautious buyer. We doubled our number of seven-figure software deals in Q1 compared to the same period last year. This growth was split about evenly between new logos and existing customers.

Here's a new logo example. A US federal law enforcement agency purchased a seven-figure software deal to unify its operations. The agency will manage its entire criminal investigation lifecycle on Appian. Sixteen-thousand agents and contractors will open cases and run investigations using a single tool. The customer expects to deploy this mission-critical app in just a few months.

A top global bank uses our platform to onboard new clients and manage ongoing relationships. The organization became a new Appian customer in 2019 and we delivered its first project in just 8 weeks with the Appian Guarantee at that time. It's purchased more software every year since. In Q1, it selected our platform to automate credit, payment, and trade-related processes for more than a thousand users globally.

Finally, a global packaging and logistics company is an existing Appian customer and uses our platform to onboard clients and manage global supply chain logistics. In Q1, it expanded with a seven-figure software purchase to license new users that oversee consumer recycling programs. They will manage the lifecycle of containers (like bottles and milk cartons) using Appian. They will also deploy an externally-facing Appian Portal to engage over one-hundred-thousand constituents in the recycling process.

Our plan this year is ‘growth with scrutiny’. That means we’ll examine all our investments, reducing those we find unproductive -- and keep growing at the same time. We are hiring in all offices and all departments. The bar is higher than in other years, but we’re still willing to make major new investments when the upside justifies it. (Our expanded development of new Solutions is a good example.) This year’s scrutiny drive has helped us become more efficient, which will ease our path to profitability in a way that does not diminish our growth rate.

Now, I’ll hand the call to Mark for a deeper look at our financials. Mark?

Mark Matheos

Thanks, Matt. I’ll review the financial highlights for the quarter, and then will provide guidance for Q2 and the full year, 2023.

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

Let’s go into the details. Cloud subscription revenue was $69.7 million, an increase of 31% year-over-year, and above guidance. On a constant currency basis, cloud subscription revenue grew 32% year-over-year. Subscriptions revenue was $99 million, an increase of 18% year-over-year. On a constant currency basis, subscriptions revenue grew 19% year-over-year. It was impacted by lower on-prem license revenue as some customers converted to the cloud this quarter and from a higher mix of new cloud bookings during the quarter.

Professional services revenue was $36.3 million, an increase of 19% year-over-year. This quarter, services revenue benefited from new large projects with existing customers and recognition of revenue that was on hold from Q4. As previously noted, we have limited visibility in services and a few large projects can influence professional services revenue in any given quarter. Long-term, we believe partners will drive the majority of our implementations. Our professional services will continue to be strategic by 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 $135.2 million, an increase of 18% year-over-year and above our guidance. On a constant currency basis, total revenue grew 19% year-over-year. Subscriptions revenue was 73% of total revenue, consistent with the year ago period and 74% in the prior quarter.

Our cloud subscription revenue retention rate was 115% as of March 31, 2023, consistent with the prior quarter. 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 33% of total revenue, consistent with the year ago period.

Our cloud software net new ACV bookings were approximately 85% of the total net new software bookings in the first quarter of 2023, an increase from 80% in 2022.

Now, I'll turn to our profitability metrics. Non-GAAP gross margin was a record 75%. It was 74% in the year ago period and 73% in the prior quarter. Subscriptions non-GAAP gross margin was 90%, consistent with the year ago period and prior quarter. Professional services non-GAAP gross margin was 34%, compared to 29% in the year ago period and 27% in the prior quarter. Higher than expected professional services revenue drove the gross margin upside in the quarter. We expect professional services non-GAAP gross margin to decline to the mid 20% range in 2023 and low 20% range beyond 2023 as 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 $119.3 million, an increase of 33% from $89.7 million in the year ago period.

Adjusted EBITDA loss was $(15.8) million, versus our guidance of a loss between $(21.0) million and $(17.0) million, compared to an adjusted EBITDA loss of $(3.4) million in the year ago period.

In the first quarter, we had approximately $600-thousand of foreign exchange gains, compared to foreign exchange losses of $(1.9) million 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 $(19.7) million or $(0.27) cents per basic and diluted share, compared to non-GAAP net loss of $(4.4) million or $(0.06) cents per basic and diluted share for the first quarter of 2022. This is based on 72.9 million basic and diluted shares outstanding for the first quarter of 2023 and 72.2 million basic and diluted shares outstanding for the first quarter of 2022.

Turning to our balance sheet, as of March 31, 2023, cash and cash equivalents and investments were $254.5 million, compared with $196.0 million as of December 31, 2022. For the first quarter, cash used by operations was $(25.3) million versus $(20.6) million for the same period last year.

Total deferred revenue was $198.7 million as of March 31, 2023, an increase of 34% 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 can 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.

Now, I'll turn to guidance.

For the second quarter of 2023, cloud subscription revenue is expected to be between $72 and $74 million, representing year-over-year growth of 26% and 30%. Total revenue is expected to be between $123 and $125 million, representing year-over-year growth of 12% and 14%.
Adjusted EBITDA loss for the second quarter of 2023 is expected to be between $(30) and $(26) million. Non-GAAP net loss per share is expected to be between $(0.46) and $(0.40) cents. This assumes 73 million basic and diluted weighted average common shares outstanding.

For the full year 2023, we are increasing cloud subscription revenue to between $296 and $298 million, representing year-over-year growth of 25% and 26%. This is an increase from prior guidance of between $294 and $296 million, representing year-over-year growth of 24% and 25%.

For the full year 2023, we are increasing total revenue to between $533 and $538 million, representing year-over-year growth of 14% and 15%. This is an increase from prior guidance of between $530 and $535 million, representing year-over-year growth of 13% and 14%.

Adjusted EBITDA loss is expected to be between $(70) and $(65) million, an improvement from prior guidance of between $(75) and $(70) million. Non-GAAP net loss per share is expected to be between $(1.16) and $(1.09). This assumes 73.2 million basic and diluted weighted average common shares outstanding.

Our guidance assumes the following:

- First, Q2 professional services revenue will be down by a low single digit rate on a sequential basis. For the full year 2023, we assume services revenue will grow at a low single digit rate year-over-year.
- Second, on-prem license revenue seasonality will make Q2 our weakest quarter of the year. Hence, you should expect on-prem license revenue to decline materially on a sequential basis.
- Third, Q2 adjusted EBITDA loss excludes severance costs of approximately $1.3 million. Q2 adjusted EBITDA loss will be higher than Q1 levels due to a combination of on-prem license seasonality and the cost of running our annual conference, Appian World. We'll continue to maintain greater scrutiny of any discretionary related expenses. This is consistent with previous years.
- Fourth, net interest expense of approximately $1.3 million in Q2 and $4.5 million in 2023.

- Fifth, capital expenditures will be between $3 and $4 million in Q2 and between $12 and $14 million in 2023. This is primarily related to build-out of additional office space.
- Finally, our guidance assumes FX rates as of May 8, 2023.

Before we take your questions, I want to briefly touch on severance costs of $4.2 million related to recent personnel changes. As part of our growth with scrutiny strategy, we flattened hierarchies, optimized some support functions, and reduced headcount in non-strategic areas. Our increased scrutiny should result in continued slowing of OPEX growth during the remainder of 2023. Accordingly, we now expect non-GAAP adjusted EBITDA loss margin to improve to better than 10% in the second half of 2023. These changes will allow us to invest in areas that will drive growth and generate superior returns long-term.

In summary, we are excited about the growth opportunities ahead of us. With that, let's turn it over to questions.

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