appian

Appian Q2 2023 Earnings Call Prepared Remarks Transcript

Sri Anantha

Thank you, Operator. Good afternoon and thank you for joining us to review Appian's second 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 third 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 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 2023 10-Q 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.

In the second quarter of 2023, Appian's cloud subscription revenue grew 30% year-over-year to $74.4 million. Subscriptions revenue grew by 22% to $93.8 million. Total revenue grew 16% year-over-year to $127.7 million. Our cloud subscription revenue retention rate was 115% as of June 30th. Our adjusted EBITDA was a loss of $(24.7) million. These results exceeded our guidance.

The best thing about this year -- so far -- has been the rise of AI into public consciousness and general interest. It is a pleasure to take customer questions, to speak about it in every forum, to write about it in the Wall Street Journal -- also, of course, to have this reason to initiate new selling conversations.

Appian has been an AI leader for years. We have developed, shipped, and deployed AI for years. We use it throughout our product. But now it's getting the attention it deserves. Customers recognize the potential but need guidance to achieve practical value.

Appian sees the AI market a little differently than other firms. I'll summarize the difference with two quick statements: **First**, AI is a partner and not a substitute for human labor. We need to work together. Businesses can expect to be routing tasks, to and from AI, as we collaborate. (Appian's leadership in workflow is advantageous here.) **Second**, data is everything. AI could make your data more valuable, but it's also a threat to data privacy. The top priority now should be to protect and defend an organization's own data. (Appian facilitates a private form of AI that will keep us differentiated from the public versions offered by our competitors.)

Let's explore for a moment that second point. AI allows data to be real-time actionable. It is in a sense the natural culmination of the data warehousing movement from the '90s. AI provides a new data structure that can make vast amounts of information instantly accessible. By reducing the access costs, it increases the value of data.

Common imagination suggests that companies will be happy to send their data (and their prompts) to public AI firms. And any lingering concerns can be easily fixed with a few contractual guarantees about not retaining the data, or a promise to redact the sensitive bits before sending it across the internet. I'm skeptical of this belief, and the conversations I've had with CIOs suggest I'm not alone. The more sensitive your data, and the more regulated your industry, the more you're going to need Private AI.

Every firm will set their own AI privacy standards, but I know what I'd be looking for. (1) no 3rd party access to my data, (2) my data shouldn't be kept or used by anyone else, and (3) I want to own every AI algorithm I train, not rent it. From what I see, no vendors in our market are seriously pursuing such a customer-first, pro-privacy position. No vendors other than Appian, that is.

Appian has two big advantages in the emerging AI battleground. We have a leading data fabric, which can gather datasets for training an AI algorithm. Our data fabric is like a virtual database, a great way to address and unify data that's physically separated. And we have a great process modeler, to route work to and from AI. We plan to lean on these two factors to create practical AI value for our customers.

We're creating practical AI value today with pre-built models. Our most popular models automate the extraction of data and classification of documents and emails. We're building more models over time, including one we just released to summarize 'request for quote' responses.

Here's a customer story about how one of our pre-built models is used. A US fire safety company is under executive mandate to standardize its financial processes and reduce payment errors by the end of this year. In Q2, the group selected Appian to automate its accounts payable processes and became a new customer. It'll train an Appian AI model to classify unique documents, identify vendor invoices, and extract payment information. Employees will review AI outputs and tune the algorithm, all within a single app. They anticipate a 5-fold increase in efficiency using our product. Their first project will be delivered in 8 weeks, under the Appian Guarantee.

This story is also a good example of our belief that AI and humans will work in collaboration on most processes. AI will become a more prominent member of process work, not a substitute for the process itself. That belief matches our skillset. Appian has been a leader in process automation for decades. Our platform orchestrates work across different agents, like humans, business rules, RPA, and AI.

Late last year with economic clouds looming I began sharing a series of metrics to provide additional transparency on how macroeconomic factors might impact our business. You can see them starting on slide 4 of our earnings presentation. They don't say a lot, this quarter. The bottom line is that there is some macro effect, but not enough to knock us off the plan we set for '23.

I'll close by sharing a few large customer examples from Q2.

A global insurance provider and existing Appian customer has grown by acquisition. It needs to unify global operations. The group is running a digital transformation initiative to automate core processes like claims management. It selected Appian as its enterprise platform standard. In Q2, it purchased a seven-figure software deal to license users in its largest geographic region. Appian's data fabric will integrate dozens of different systems into a comprehensive customer management application for tens of thousands of agents.

Next, a top Canadian pension fund manages billions of dollars in investments. It's aiming to double its portfolio size. The group bought Appian two years ago to digitize its investment management processes. Its first app reduced the time it takes to assess potential investments by 90%. The customer is starting its next phase of projects and signed a seven-figure software deal in Q2. Now, over half the organization will use Appian.

My last example is a top US health insurance provider and new logo. In Q2, it selected our platform to replace an inflexible call center system by the end of this year. It purchased a seven-figure software deal and will build a customer management tool for sixteen-hundred call center agents. We won this deal after proving our platform's speed and flexibility with a custom proof-of-concept built in 2 weeks. The customer expects to save millions of dollars every year using Appian.

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 Q3 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 Life Sciences.

Let's go into the details. Cloud subscription revenue was $74.4 million, an increase of 30% year-over-year, and above guidance. On a constant currency basis, cloud subscription revenue grew 27% year-over-year. Subscriptions revenue was $93.8 million, an increase of 22% year-over-year. On a constant currency basis, subscriptions revenue grew 19% year-over-year. Consistent with the prior quarter, subscriptions revenue growth was impacted in part by some customers converting to the cloud and from a higher mix of new cloud bookings during the quarter.

appian

Professional services revenue was $33.9 million, an increase of 2% year-over-year. On a constant currency basis, professional services revenue declined 2% year-over-year. As previously noted, our ability to predict services revenue is limited and a few large projects can influence growth in any given quarter. Long-term, we believe partners will drive the majority of our implementations. 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 $127.7 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 73% of total revenue, consistent with the prior quarter and 70% in the year ago period.

Our cloud subscription revenue retention rate was 115% as of June 30, 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 38% of total revenue, compared to 35% 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 85% of the total net new software bookings in the first half of 2023, an increase from 80% in 2022.

Now, I'll turn to our profitability metrics. Non-GAAP gross margin was 73%, compared to 75% in the prior quarter and 71% in the year ago period. Subscriptions non-GAAP gross margin was 89%, consistent with the year ago period and 90% in the prior quarter. Professional services non-GAAP gross margin was 28%, compared to 30% in the year ago period and 34% in the prior 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 $119.7 million, an increase of 14% from $105.1 million in the year ago period.

Adjusted EBITDA loss was $(24.7) million, versus our guidance of a loss between $(30.0) million and $(26.0) million, and compared to an adjusted EBITDA loss of $(25.0) million in the year ago period.

In the second quarter, we had approximately $1.2 million of foreign exchange gains, compared to foreign exchange losses of $(6.5) 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 $(28.5) million or $(0.39) cents per basic and diluted share, compared to non-GAAP net loss of $(33.4) million or $(0.46) cents per basic and diluted share for the second quarter of 2022. This is based on 73.0 million basic and diluted shares outstanding for the second quarter of 2023 and 72.4 million basic and diluted shares outstanding for the second quarter of 2022.

Turning to our balance sheet, as of June 30, 2023, cash and cash equivalents and investments were $237.0 million, compared with $196.0 million as of December 31, 2022. For the second quarter, cash used by operations was $(11.9) million versus $(29.7) million for the same period last year.

Total deferred revenue was $195.4 million as of June 30, 2023, an increase of 28% 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.

Now, I'll turn to guidance.

For the third quarter of 2023, cloud subscription revenue is expected to be between $75.5 and $76.5 million, representing year-over-year growth of 25% and 26%. Total revenue is expected to be between $134 and $136 million, representing year-over-year growth of 14% and 15%.

Adjusted EBITDA loss for the third quarter of 2023 is expected to be between $(16) and $(12) million. Non-GAAP net loss per share is expected to be between $(0.28) and $(0.23) cents. This assumes 73.3 million basic and diluted weighted average common shares outstanding.

For the full year 2023, we are increasing cloud subscription revenue to between $299 and $301 million, representing year-over-year growth of 26% and 27%. This is an increase from prior guidance of between $296 and $298 million, representing year-over-year growth of 25% and 26%.

For the full year 2023, we are increasing total revenue to between $538 and $543 million, representing year-over-year growth of 15% and 16%. This is an increase from prior guidance of between $533 and $538 million, representing year-over-year growth of 14% and 15%.

Adjusted EBITDA loss is expected to be between $(67) and $(63) million, an improvement from prior guidance of between $(70) and $(65) million. Non-GAAP net loss per share is expected to be between $(1.16) and $(1.10). This assumes 73.2 million basic and diluted weighted average common shares outstanding.

Our guidance assumes the following:

- First, Q3 and full year 2023 professional services revenue will grow at a mid single digit rate compared to the year ago period.
- Second, on-prem license revenue will be up on a sequential basis, consistent with seasonality. Year-over-year growth will continue to be impacted in part by some customers converting their contracts to cloud subscription.
- Third, Q3 adjusted EBITDA loss should improve both sequentially and year-over-year. We continue to expect non-GAAP adjusted EBITDA margins to come in better than 10% in the second half of 2023.
- Fourth, total other non-operating expenses of approximately $2 million in Q3 and $5.4 million in 2023.
- Fifth, capital expenditures of approximately $2 million in Q3 and between $12 and $13 million in 2023. This is primarily related to build-out of additional office space.
- Finally, our guidance assumes FX rates as of August 1, 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, let’s turn it over to questions.