Appian Q2 2024 Earnings Call Prepared Remarks Transcript

Jack Andrews, VP of Investor Relations

Thank you, Operator. Good morning and thank you for joining us. Today, we will review Appian's second quarter 2024 financial results. With me are Matt Calkins, Chairman and Chief Executive Officer and Mark Matheos, Chief Financial Officer. After prepared remarks, we will open the call for questions.

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 2024; 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 2023 10-K, our Q2 2024 10-Q filing, and other periodic filings with the SEC. These documents are available on the "Investors" section of our website.

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

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

Matt Calkins, Chairman and Chief Executive Officer

Thanks, Jack. In the second quarter of 2024, Appian's cloud subscription revenue grew 19% year-over-year to $88.4 million. Subscriptions revenue grew 20% to $113.0 million. Total revenue grew 15% year-over-year to $146.5 million. Our cloud subscription revenue retention rate was 118% as of June 30th. Adjusted EBITDA was a loss of ($10.5) million.

Appian is a growth company, and revenue growth continues to be our top priority. But we aren't indifferent to efficiency. We've applied more scrutiny to investments and steadily improved our profitability. This quarter, we took action to reduce specific non-strategic, go-to-market expenditures. With these moves, we now expect to breakeven on adjusted EBITDA for the full year 2024. Mark will provide more details in his prepared remarks.

Recently, I've immersed myself in our sales and marketing functions. I've spoken extensively with hundreds of customers, prospects, partners, and Appian staff. Together, we've discovered ways we can better allocate resources and align energy behind our business strategy. We're leaning into areas where the return on investment is the strongest, specifically large transactions and our best industry verticals.

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Appian's particular advantage is at the high end of our market. It's where we've experienced our most success. Appian appeals to the C-suite, the large enterprise, and the mission critical use case. Here, we have some of our highest win rates, highest expansion rates, and highest retention rates. And for good reason. Our platform delivers the greatest impact to the most discerning customers. Our gross retention rate of 99% is best in class in enterprise software. Many of our largest customers save millions of dollars and thousands of labor hours every year with Appian.

Our key verticals continue to be our growth engine. Over 70% of Appian's revenue comes from Financial Services, Life Sciences, and Public Sector. Roughly half of the world's largest companies and US agencies in these verticals are also Appian customers. We have decades of specialized industry expertise and a proven track record of automating the most complex processes for these organizations.

Public Sector is one of our most successful verticals. We have momentum with our GAM suite (Government Acquisition Management, GAM suite). Agencies use GAM to manage their detailed processes for procuring goods and services. We continue to invest in the suite because adoption has been strong. GAM bookings more than doubled in the first half of this year compared to the same period last year. To build on this momentum, we launched a service this spring to complement GAM. ProcureSight is an AI-driven website that consolidates major public procurement datasets. Government professionals can use it to synthesize past procurements and generate new procurement documents. Dozens of federal agencies use ProcureSight today.

For example, one agency that manages emergency responses to natural disasters purchased a seven-figure software deal and became a new Appian customer in Q2. Given the rise in wildfires, the agency needs to respond to incidents faster. It'll use our full GAM suite to reduce the time it takes to

procure firefighting resources. Before Appian, the agency ran procurement operations across a combination of disparate systems and physical paper forms. Now, it'll manage billions of dollars of annual procurements on Appian.

Another federal agency that supports national security and defense became an Appian customer this quarter. It wants to replace an inflexible procurement system that's costly to maintain. The agency has strict application hosting requirements because its data is sensitive. In Q2, it purchased a seven-figure software deal for GAM and will deploy it onto the Appian Government Cloud. As a reminder, Appian was one of the first dozen or so companies to receive a Provisional Authorization at Impact Level 5. Now, the agency can securely deploy GAM to the cloud and maintain a low total cost of ownership for its Appian applications.

Within Life Sciences, we signed a top global clinical research organization as a new customer this quarter. Our platform will manage the organization's process for selecting clinical study sites. Appian Data Fabric will bring together data from many systems into a single application so site investigators and project managers can select locations based on the study's criteria, resourcing capacity, and a country's regulations. The company used to manage this complex process manually across systems. Now, it aims to make selections 80% faster using Appian.

We continue to sign large expansion deals within Appian's Financial Services vertical. Earlier this year, we launched a new pricing structure to upsell our existing customers and monetize our latest features, like Appian AI. Here's an example of this upsell strategy: In Q2, an international insurance company increased its annual Appian software spend by more than 50%. The insurer has been a customer for a few years and uses our platform to manage claims disputes. This quarter, it purchased a seven-figure software deal

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to upgrade to our new pricing and access our latest features. It will add thousands more users to the process and deploy Appian AI to categorize millions of claims. We won this deal because AI is a native feature of our platform and easy to adopt.

Appian AI enhances worker productivity by, among other things, generating code based on a prompt, summarizing large amounts of data, and recommending user responses. Our AI is powerful because it has the context of the customer's processes and data. (It has the context.) Our AI is private because we use Data Fabric, and retrieval augmented generation (or "RAG") to avoid training an AI algorithm. (We don't train them.) This quarter, usage of Appian AI doubled compared to last quarter. Here's an example:

In Q2, a medical transportation and emergency response company automated its claim dispute processes with Appian. Under new government regulation, the company has 20 days to appeal disputes. Now, case workers respond more efficiently using our automation capabilities. First, Appian AI classifies and ingests payer disputes. Then, Appian RPA bots retrieve data for the user from various systems about the medical incident. With Appian, our customer expects to handle disputes faster, increasing revenue by tens of millions of dollars annually.

Appian is a leading process automation platform. The completeness of our platform is appreciated by users and recognized by analysts. Analysts call us leaders in enterprise low-code application development, business workflow automation, digital process automation, and process orchestration. In Q2, Appian was named a leader in the Gartner Magic Quadrant for Process Mining Platforms for the first time. We were included because of Appian ProcessHQ, which we just released in April. ProcessHQ is real-time actionable process mining, tracking the health of processes and using AI to recommend improvements.

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A top medical insurance provider manages claim disputes and payouts on Appian. This quarter, it analyzed this process with ProcessHQ because it wanted to be more efficient. The company discovered members were submitting tens of thousands of duplicate claims. Now, it can work to optimize the process, eliminate unnecessary submissions, and save millions of hours annually.

Earlier this week, the Court of Appeals of Virginia, the state's intermediate appellate court, rendered an opinion on our trade secrets case against Pegasystems. We look forward to appealing this week's decision, and are hopeful that the state's highest court, the Virginia Supreme Court, will reinstate in full the jury's verdict, including its award of over $2 billion against Pegasystems for willfully and maliciously misappropriating Appian's trade secrets. Nothing in this week's opinion changes the fact that Pegasystems was found to have committed computer fraud in violation of the Virginia Computer Crimes Act. That unanimous finding by the jury was not disturbed by this week's decision, and Pegasystems did not even attempt to contest its violation of the Virginia Computer Crimes Act on appeal. For Appian's perspective on this sordid affair, I refer you to our website, appian.com/pega.

I'm optimistic about Appian's future. We deliver our customers a great product and a great experience. Appian's commitment to efficient growth will allow us to continue innovating, while delivering value to our stakeholders.

Now, I'll hand the call over to Mark for a deeper discussion of the financials. Mark?

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Mark Matheos, Chief Financial Officer

Thanks, Matt, and thank you to everyone joining us today. I'll review the financial highlights for the quarter, and then will provide guidance for the third quarter and full year 2024.

Our key metrics of cloud revenue, total revenue, and adjusted EBITDA all came in above the high end of our guidance ranges. Cloud subscription revenue was $88.4 million, an increase of 19% year-over-year. Our cloud subscription gross renewal rate remained stable at 99%, up slightly from 98% a year ago, and consistent with the prior quarter. Our cloud subscription revenue retention rate was 118% as of June 30, 2024, compared to 115% a year ago, and 120% in the prior quarter. We continue to target a cloud subscription revenue retention rate of 110% to 120% on a quarterly basis. Approximately 82% of our total net new software bookings in the quarter was for the cloud, compared to 84% in the prior year's second quarter. Total subscriptions revenue was $113.0 million, an increase of 20% year-over-year.

Professional services revenue was $33.5 million, down 1% year-over-year. As we've stated previously, professional services revenue can fluctuate quarter to quarter, due to the timing of large projects. We leverage our professional services to enable partners and drive customer success. Over the long-term, we expect professional services revenue to continue to decline as a percentage of total revenue.

Total revenue was $146.5 million, an increase of 15% year-over-year. Subscription revenue represented 77% of total revenue, compared to 73% in the year ago period, and 79% in the prior quarter. We continue to see global demand for our platform, with our international operations contributing 38% of total revenue, consistent with the year ago period. Foreign exchange movements provided a modest revenue headwind of slightly less than 1% this quarter.

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Turning to profitability metrics:

- Non-GAAP gross margin was 75%, compared to 73% in the year ago period, and 76% in the prior quarter.

- Subscriptions non-GAAP gross profit margin was 89%,consistent with the year ago period, and 90% in the prior quarter.

- Professional services non-GAAP gross margin was 30%, compared to 28% in the year ago period, and up from 25% in the prior quarter. Our goal is to enable our customers to achieve positive business outcomes and increase adoption of our technology platform. To help accomplish this goal, we continue to invest in non-billable areas of our services organization. As stated previously, we expect professional services non-GAAP gross margin to decline to the low 20% range in 2024 and beyond.

Total non-GAAP expenses were $123.2 million, up 3% from $119.7 million in the year ago period.

Adjusted EBITDA loss was $(10.5) million for the quarter, well ahead of our second quarter guidance of a loss between $(17) and ($13) million, and significantly improved from an adjusted EBITDA loss of ($24.7) million in the year ago period.

In the second quarter, we had approximately $200-thousand of foreign exchange losses, compared to $1.2 million in foreign exchange gains in the same period a year ago. As a reminder, we do not forecast movements in FX rates. Therefore, FX movements are not considered in our guidance.

Non-GAAP net loss was $(19.1) million, or $(0.26) cents per share, compared to a non-GAAP net loss of $(28.5) million, or $(0.39) cents per diluted share for the second quarter of 2023.

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Turning to our balance sheet, as of June 30th, 2024, cash, cash equivalents, and investments were $149.1 million. This provides us with significant liquidity to operate and invest in our business. For the second quarter, cash used by operating activities was ($17.6) million, versus cash used by operating activities of ($11.9) million for the same period last year. The increase in cash usage was driven primarily by the timing of facilities and vendor payments.

Finally, total deferred revenue was $222.9 million as of the second quarter of 2024, an increase of 14% from the year ago period. As a reminder, while the majority of our customers are invoiced on an annual upfront basis, we also have some large customers that are billed quarterly or monthly. Consequently, we continue to believe cloud subscription revenue is a better indicator of our business momentum than deferred revenue, billings, or remaining performance obligations. These 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 Appian's 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.

As Matt mentioned, we have made adjustments to our expenses to align with our strategy. These include a reduction in personnel and some consolidation of facilities. Looking ahead to the second half of 2024, we believe these actions will accelerate our path to profitability. We previously forecasted adjusted EBITDA breakeven in 2025. Now, we expect to achieve this milestone for the full year 2024.

Let's turn to the specifics of our guidance.
- For the third quarter of 2024, cloud subscription revenue is expected to be between $89 and $91 million, representing year-over-year growth between 15% and 18%.

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- Total revenue is expected to be between $149 and $153 million, representing year-over-year growth between 9% and 12%.

- Adjusted EBITDA for the third quarter of 2024 is expected to range between breakeven and positive $3 million.

- Non-GAAP net loss per share is expected to range between $(0.10) cents to $(0.06) cents. This assumes 72.4 million diluted weighted average common shares outstanding.

For the full year 2024, we are slightly reducing our cloud revenue and total revenue guidance. We believe it is prudent to factor in some potential uncertainty into our near-term outlook given the personnel changes we discussed earlier. At the same time, we are significantly improving our full year adjusted EBITDA guidance.

- Cloud subscription revenue is now expected to be between $358 to $360 million, representing year-over-year growth of 18%.

- Total revenue is now expected to be between $610 to $615 million, representing year-over-year growth between 12% and 13%.

- We now expect adjusted EBITDA to range from negative $(3) million to positive $3 million. This is an improvement of $20 million from the midpoint of our previous guidance range.

- We are also updating our full year 2024 non-GAAP net loss per share to range between $(0.61) cents to $(0.52) cents. This assumes 72.6 million diluted weighted average common shares outstanding.

Our guidance assumes the following:

- First, as previously disclosed, the variability in our services revenue can be swung by one or two large transactions. We expect professional services revenue to be flat to down sequentially in Q3.

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- Second, we expect on-prem license revenue in Q3 will increase sequentially and track to seasonality that is consistent with prior periods.

- Third, total other income and interest expenses are expected to be between $4 and $5 million in Q3, and between $17 and $18 million for the full year 2024.

- Fourth, capital expenditures are expected to be between $1 and $2 million in Q3, and between $5 and $7 million for the full year 2024.

- And fifth, our guidance assumes FX rates as of July 29th, 2024.

In closing, we're pleased about our commitment to accelerating adjusted EBITDA breakeven on a non-GAAP basis from 2025 to this year. We'll continue to focus on growth while driving greater efficiencies in the business. We believe that the unique capabilities of our platform position us well to capture the large market opportunity ahead of us.

And with that, we will open the line for questions. Operator?