

Sophos Group plc FY20 H1 Results

6 November 2019

SOPHOS

Safe Harbour

Cautionary Statement

The following presentation is being made only to, and is only directed at, persons to whom such presentation may lawfully be communicated (“relevant persons”). Any person who is not a relevant person should not act or rely on this presentation or any of its contents. Information in the following presentation relating to the price at which relevant investments have been bought or sold in the past or the yield on such investments cannot be relied upon as a guide to the future performance of such investments. For the avoidance of doubt, nothing in this presentation should be construed as a profit forecast.

The information, statements and opinions contained in this presentation do not constitute a public offer under any applicable legislation, an offer to sell or solicitation of any offer to buy any securities or financial instruments in Sophos Group plc (the “Company”) or any company which is a subsidiary of the Company. Further this presentation does not provide any advice or recommendation with respect to any such securities or other financial instruments.

The release, publication, or distribution of this presentation in certain jurisdictions may be restricted by law, and therefore persons in such jurisdictions into which this presentation is released, published or distributed should inform themselves about, and observe, such restrictions.

Forward-looking Statements

Certain statements contained in this presentation constitute forward-looking statements. All statements other than statements of historical facts included in this presentation, including, without limitation, those regarding the Company’s financial condition, business strategy, plans and objectives, are forward-looking statements. These forward-looking statements can be identified by the use of forward-looking terminology, including, for example, the terms “believes”, “estimates”, “anticipates”, “expects”, “intends”, “may”, “will”, or “should” or, in each case, their negative or other variations or comparable terminology. Such forward-looking statements involve known and unknown risks, uncertainties and other factors, which may cause the actual results, performance or achievements of the Company, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such forward-looking statements are based on numerous assumptions regarding the Company’s present and future business strategies and the environment in which the Company will operate in the future. Such risks, uncertainties and other factors include, among others: inherent difficulty in predicting customer behaviour; customers may not respond as we expected to our sales and marketing activities; the competitive environment; our ability to adapt to technological change; business interruption or failure of our systems architecture and communication systems; problems with implementing upgrades to our applications and supporting information technology infrastructure; any failure to properly use and protect personal customer information and data; our ability to manage and maintain third party business partnerships; increased regulation of our businesses; changes in laws; any failure to process transactions effectively; any failure to adequately protect against potential fraudulent activities; any significant quality problems or delays; the global macro-economic environment; the potential for one or more countries exiting the Eurozone; the implications of the exercise by the United Kingdom (the “UK”) of Article 50 of the Treaty of Lisbon and the disruption that may result in the UK and globally from the withdrawal of the UK from the European Union; our inability to attract, retain and develop talented people; our ability to repurchase shares; our inability to adequately protect our intellectual property rights; disruptions, expenses and risks associated with any acquisitions and divestitures; amortisation of acquired intangible assets and impairment charges; our use of debt to finance acquisitions or other activities; and the cost of, and potential adverse results in, litigation involving intellectual property, competition authority, shareholders and other matters. These forward-looking statements speak only as at the date of this presentation. Except as required by the Financial Conduct Authority, or by applicable law, the Company does not undertake any obligation to update or revise publicly any forward-looking statement, whether as a result of new information, future events, or otherwise.

Business Update

Kris Hagerman, CEO

Note:

Sophos is currently in an offer period and the discussion today will be limited to the financial results for the period under review

SOPHOS

H1 FY20 Summary

- Revenue and billings⁽¹⁾ grew by 8% and 9% respectively at constant currency (“CC”)
 - Next-gen⁽²⁾ transition continues, now over 56% of total billings
 - Subscription business remains strong
 - Strong growth in Sophos Central, underpins next-gen and cross-sell
 - Growth in Enduser, Network, New Business, and MSP⁽³⁾
- Pre-tax loss after exceptional items of \$2 million (PBT \$26 million in H1 FY19)
 - Adjusted operating profit⁽⁴⁾ flat YOY at \$49 million, after further investment
- Technology and Innovation
 - Launched Sophos MTR, leveraging best-in-class protection of Intercept X Advanced EDR endpoint
 - EAP (Early Access Program) now open for XG Firewall v18, available to all partners and customers
- We continue to execute on an effective and differentiated strategy

H1 FY20 Financial Performance Overview

Billings and revenue growth, with profit and cash flow aided by IFRS 16

7.9%

Constant Currency Revenue

+4.7% at actual rates

Subscription revenue +11.1% (CC)

Hardware -4.6% (CC)

\$49.4M

Adjusted Operating Profit⁽⁴⁾

vs. \$49.9M H1 FY19

Flat YOY with revenue growth
and further investment

\$93.8M

Net Cash Flow from Operations

vs. \$81.5M H1 FY19

Absence of FY19 VPP payment
Profitability improvement
IFRS 16 benefit

\$372.0M

Billings⁽¹⁾

vs. \$352.7M H1 FY19

Up 8.7% YOY (CC)

Modest YOY lift in net renewal rate

New business +6% (CC) driven by MSP

\$66.8M

Cash EBITDA⁽⁵⁾

vs. \$54.0M H1 FY19

Billings growth with a benefit from IFRS 16
partially offset by further investment

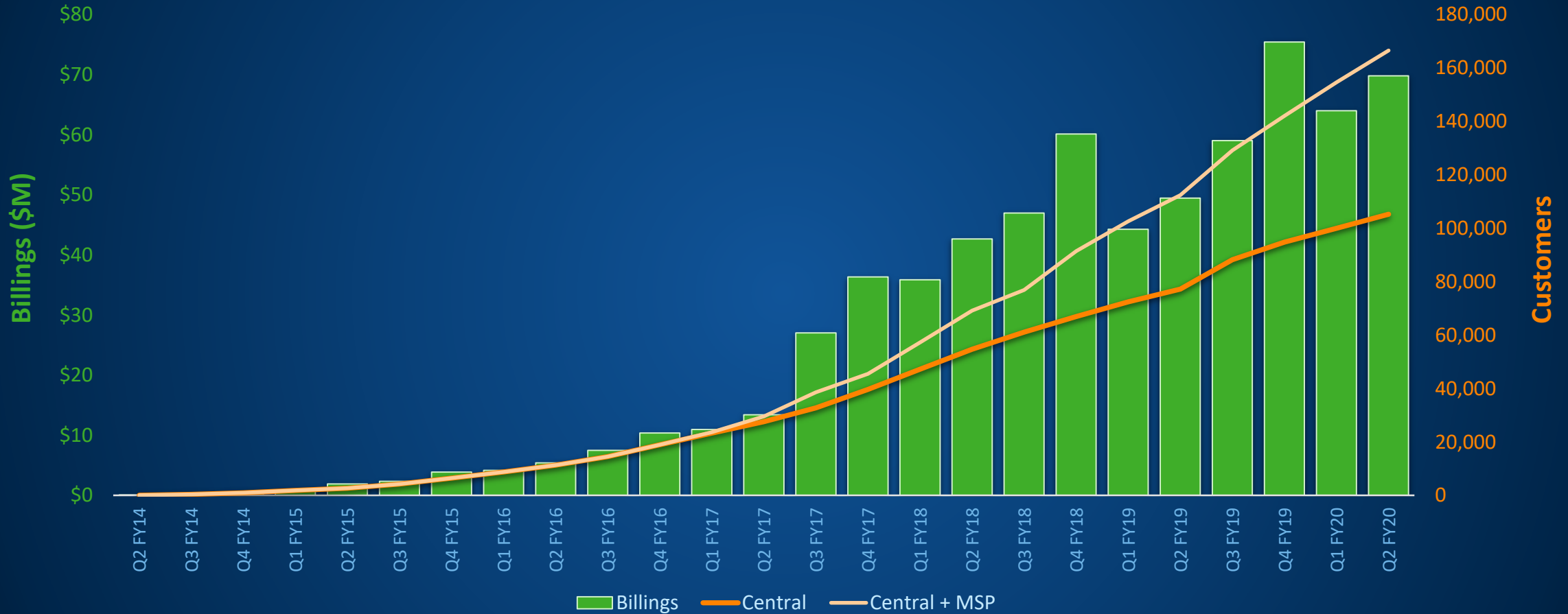
\$90.4M

Unlevered Free Cash Flow⁽⁶⁾

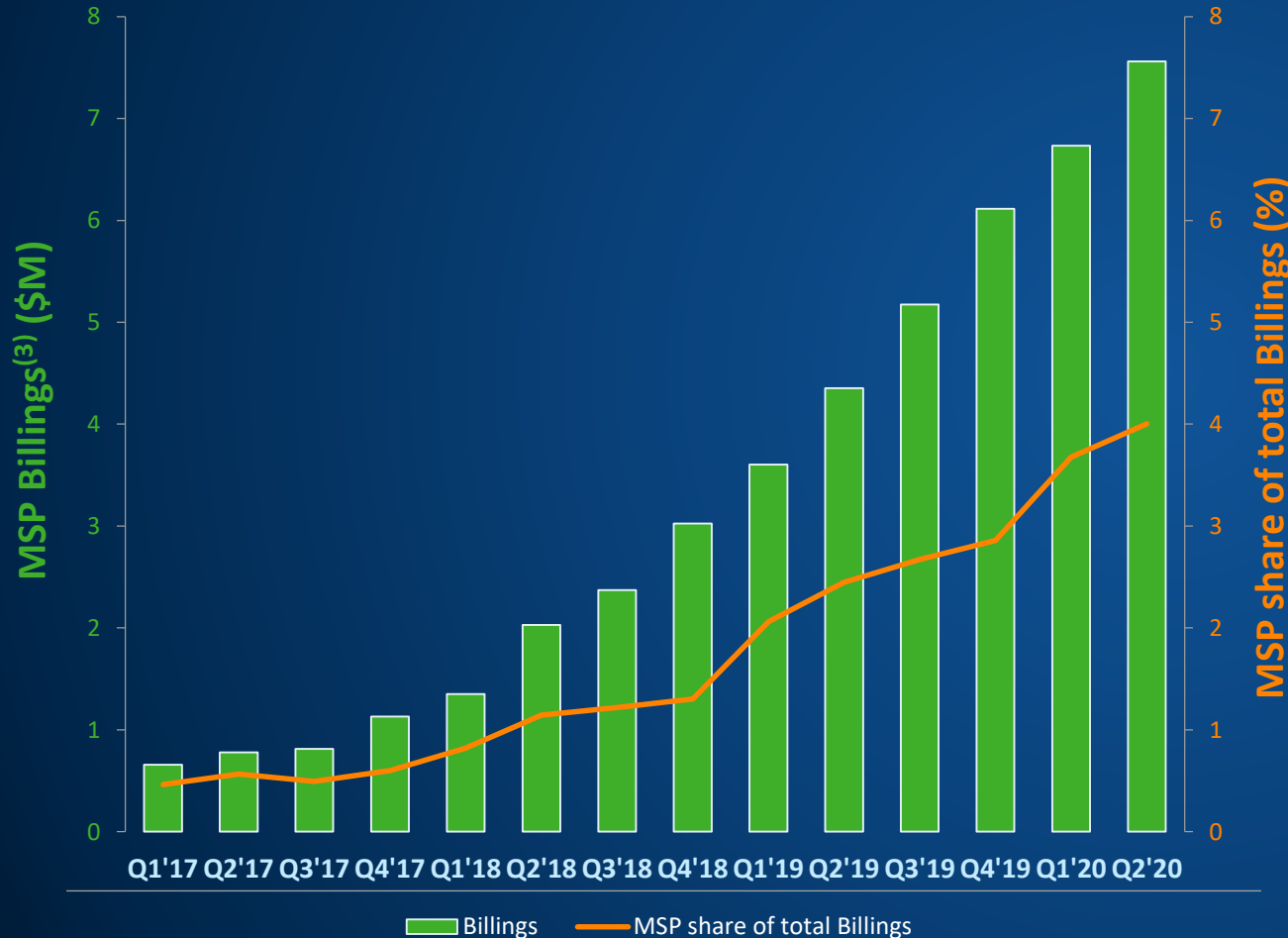
vs. \$71.6M H1 FY19

Absence of FY19 VPP payment
Profitability improvement

Continued Sophos Central Growth



Managed Service Provider (“MSP”) Channel



- Sophos Central and Synchronized Security represent compelling offering for MSP partners
- Particularly attractive model for smaller customers
- MSP business is billed monthly and recognized to revenue immediately
- MSP billings⁽³⁾ in Q2 FY20 equate to \$32.8 million in ARR
- Sophos MTR provides an additional opportunity for MSP partners

Consistent Growth in Number of Customers



- **Term customers:** closed H1 with 347K term customers (excluding MSP customers), compared to 317k a year ago
- **Total customers:** closed H1 with a total of 409K customers (including both term and MSP customers), compared to 353K a year ago

Expert-Led Threat Response

Managed Threat Response (“MTR”)

- Others Stop at Notification. We Take Action.
- 24/7 threat hunting, detection, and response delivered by an expert team as a fully-managed service.



Analyst-Led Threat
Hunting and Response



Targeted Actions to
Neutralize Threats



Complete Transparency
and Control



Financial Results

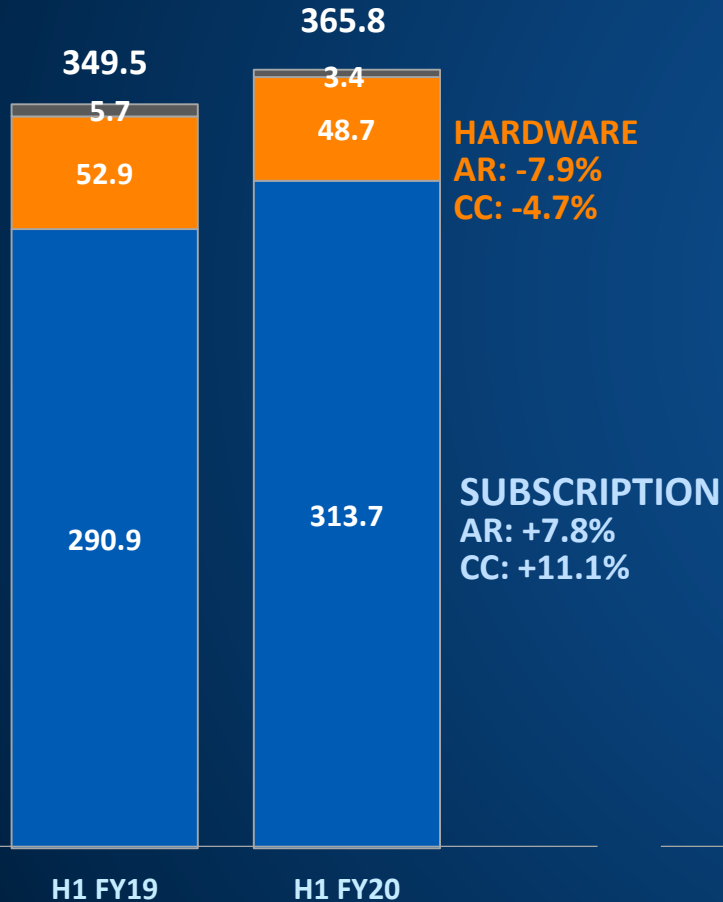
Nick Bray, CFO

SOPHOS

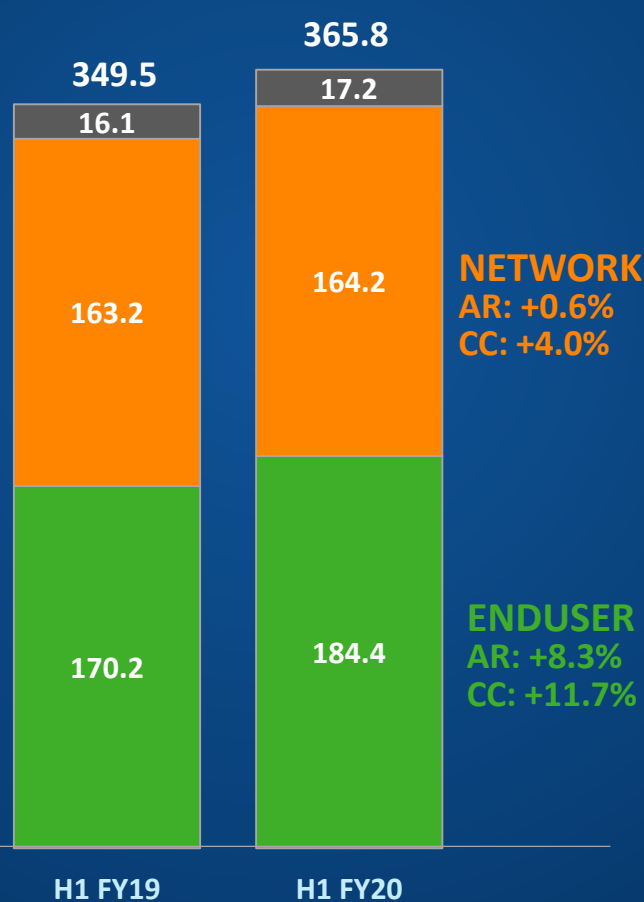
Revenue Performance

Revenue growth of 4.7%, or 7.9% at constant currency

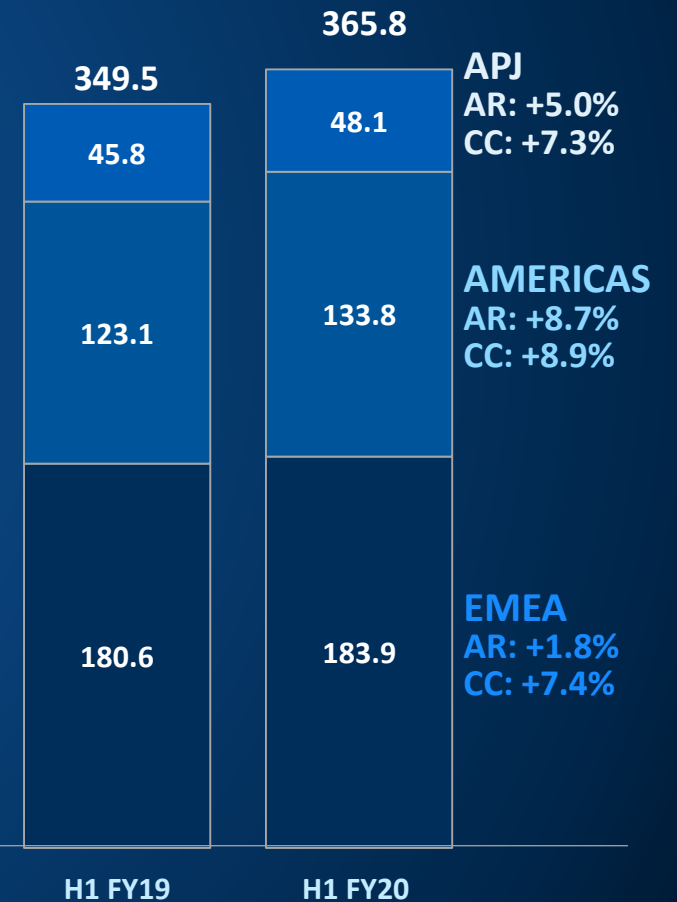
REPORTED REVENUE BY TYPE (\$M)



REPORTED REVENUE BY PRODUCT (\$M)



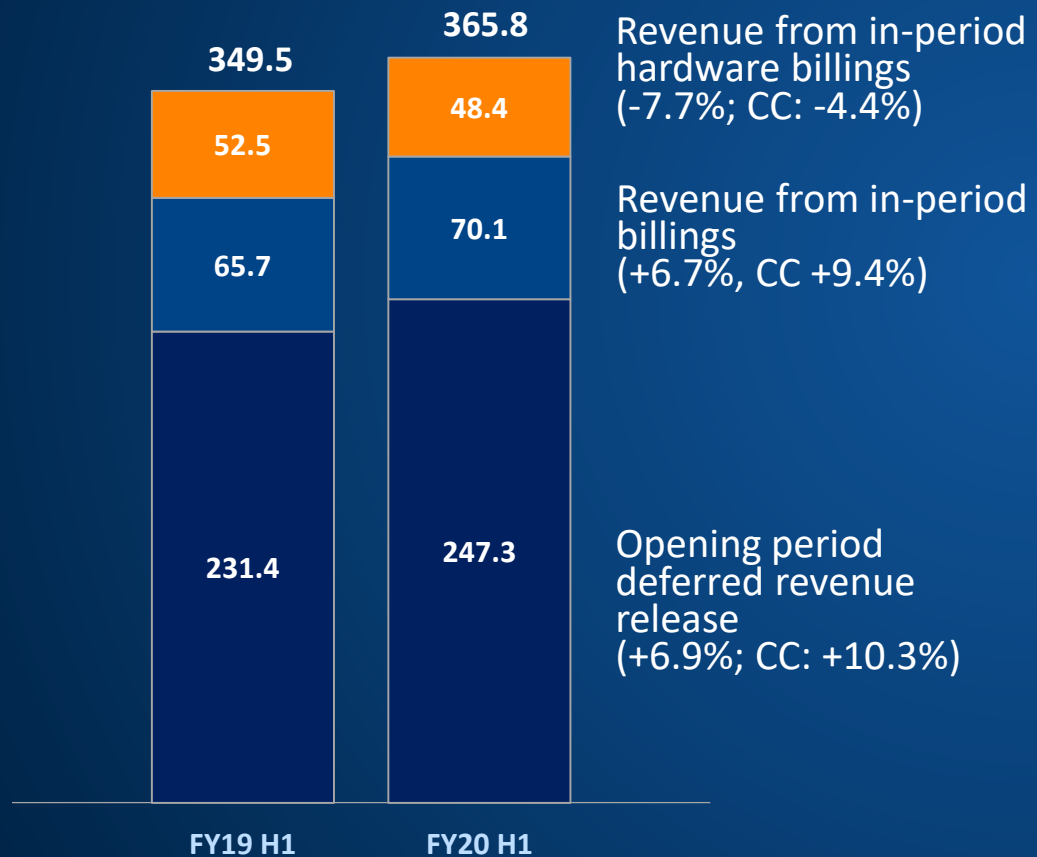
REPORTED REVENUE BY REGION (\$M)



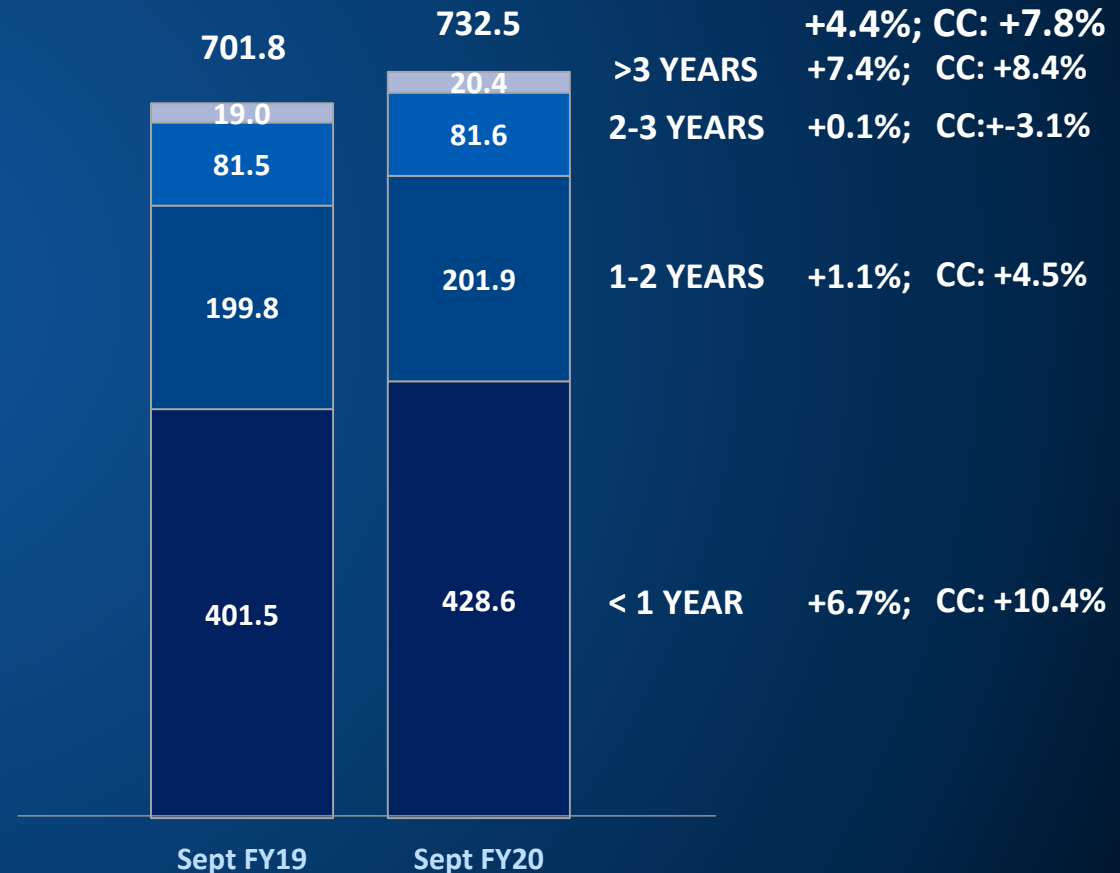
Revenue by Year of Recognition

Deferred revenue growth driven by subscription billings growth, partially offset by FX

REPORTED REVENUE BY SOURCE (\$M)



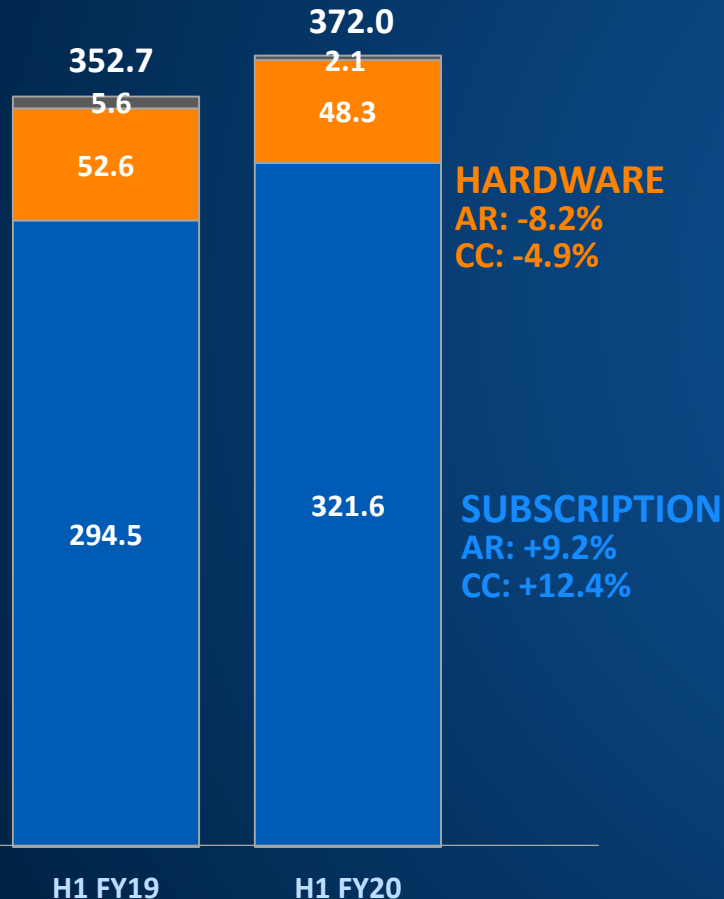
DEFERRED REVENUE (\$M)



Billings Performance

Subscription billings⁽¹⁾ growth of 12.4% at constant currency, or 9.2% at actual rates

REPORTED BILLINGS BY TYPE (\$M)



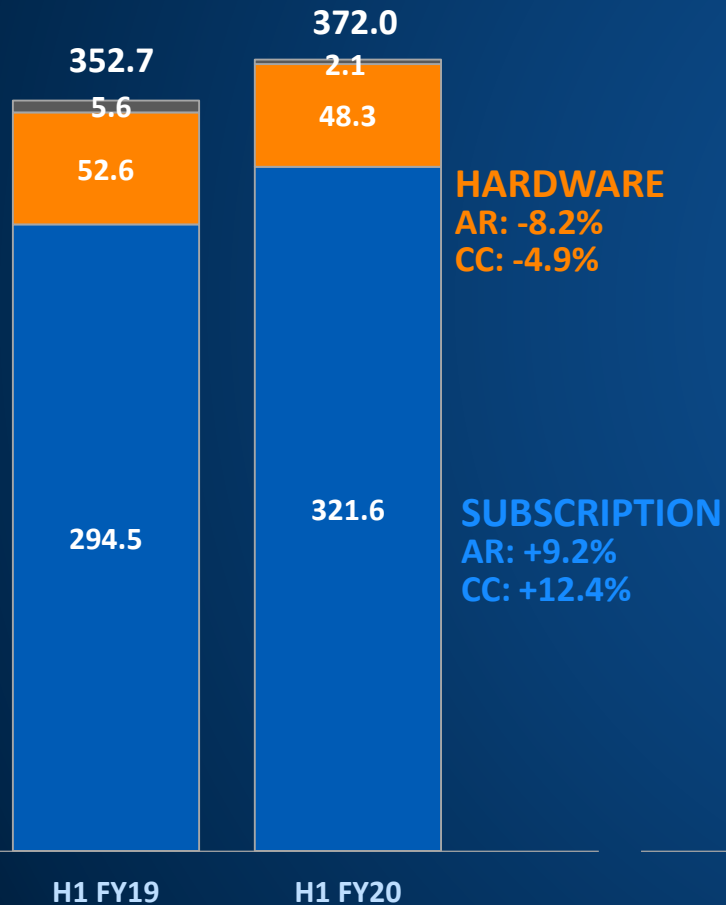
BILLINGS DRIVERS

- Brand new customer billings⁽⁷⁾ up 6% at constant currency
- Mix shift with larger transactions remaining stable and growing MSP business (smaller customers, monthly billings)
- Existing customers renewal rates⁽⁸⁾ at 121% (H1 FY19 118%)
- High visibility of the renewal book⁽⁹⁾

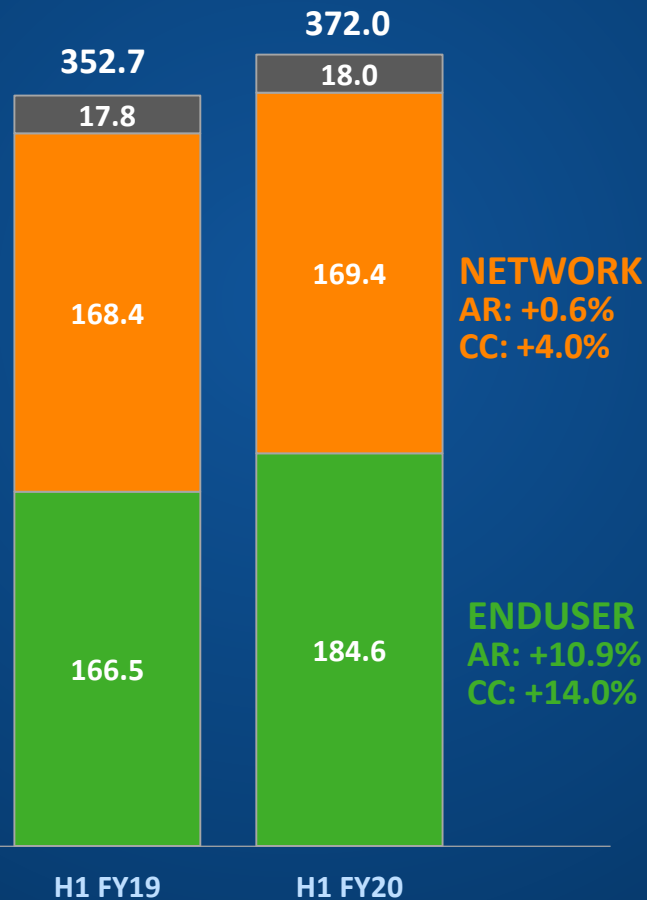
Billings Performance

Subscription billings⁽¹⁾ growth of 12.4% at constant currency, or 9.2% at actual rates

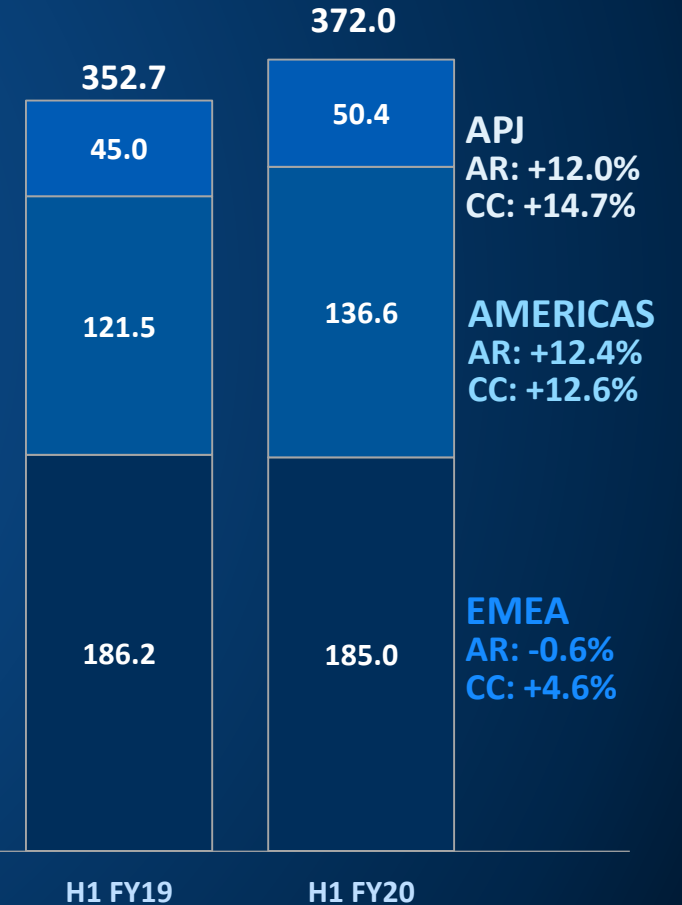
REPORTED BILLINGS BY TYPE (\$M)



REPORTED BILLINGS BY PRODUCT (\$M)

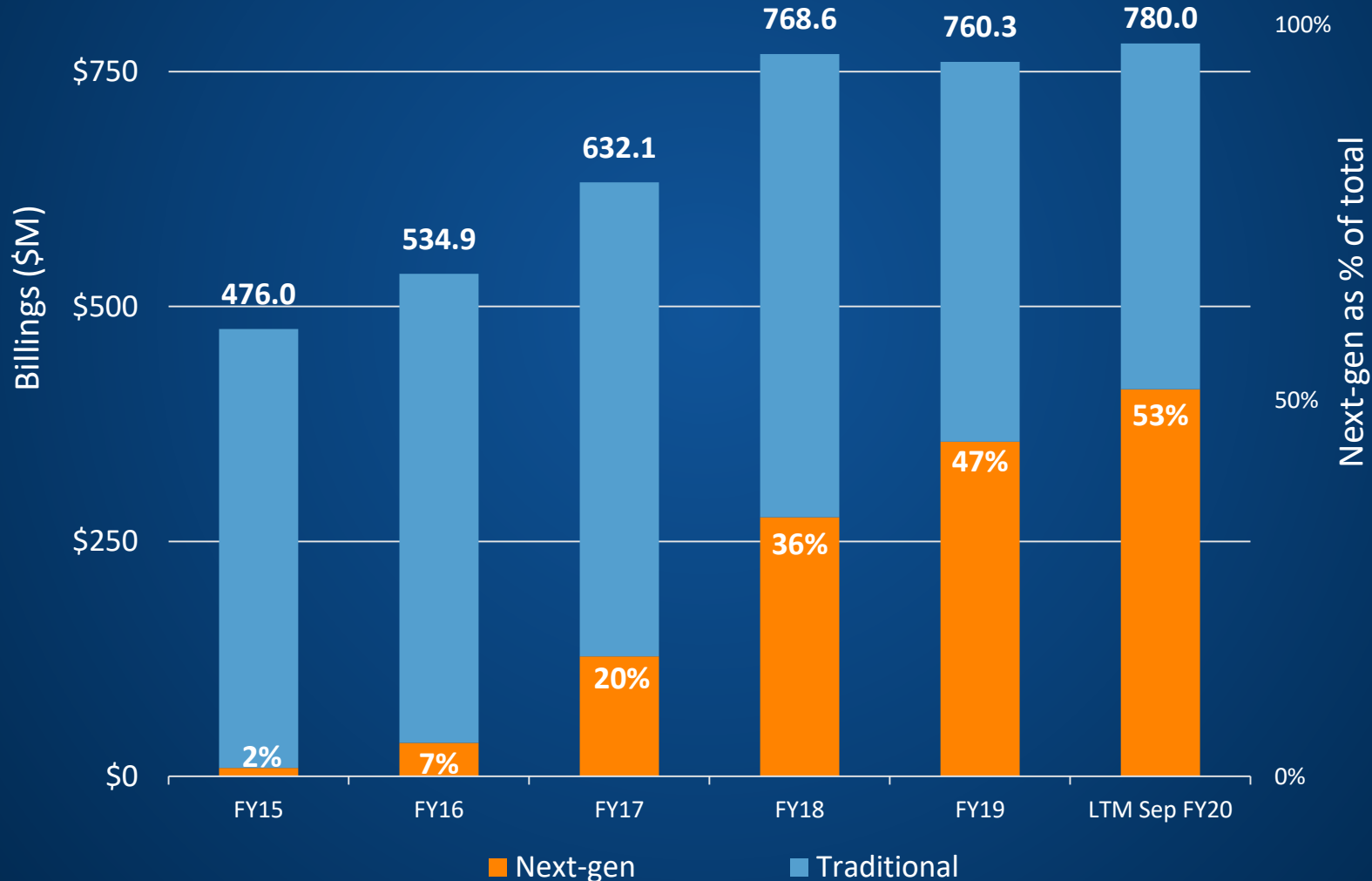


REPORTED BILLINGS BY REGION (\$M)



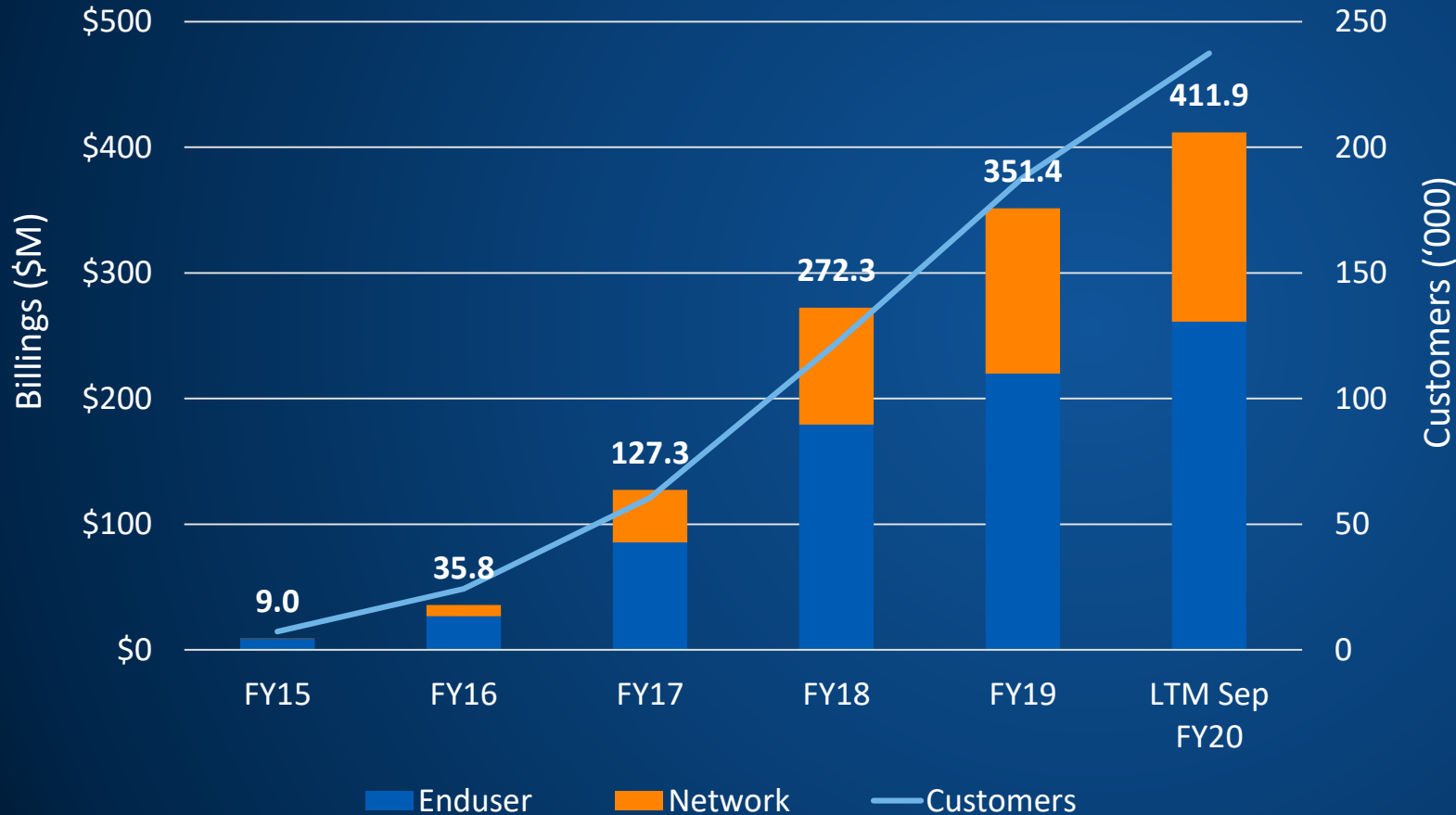
Next-Gen Transition

Continued strong growth in next-gen products; 40% at constant currency in H1 FY20



Next-Gen Portfolio Progress

Next-gen growth in both Enduser and Network

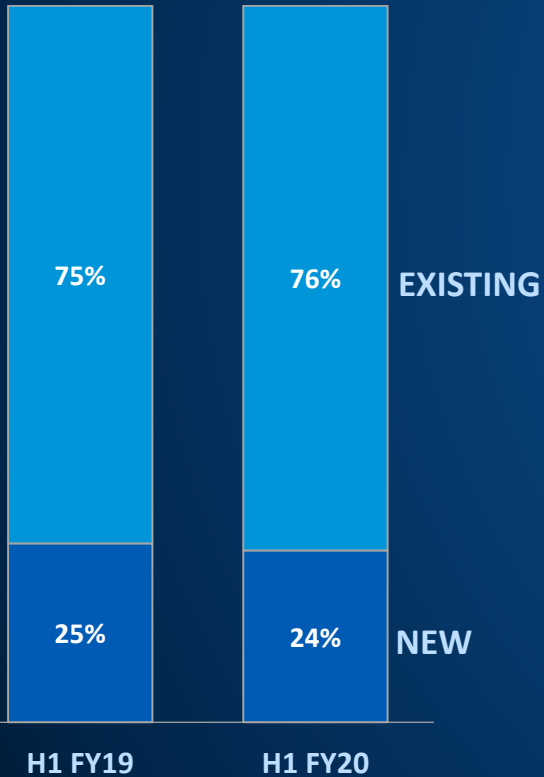


- Net increase in next-gen customers in H1 FY20 of over 45,000 (incl. MSP)
- c.95% of new customer business in Endpoint is next-gen, and c.65% in UTM/firewall

Key Billings Metrics

Continuing to see effects of MSP in the mix

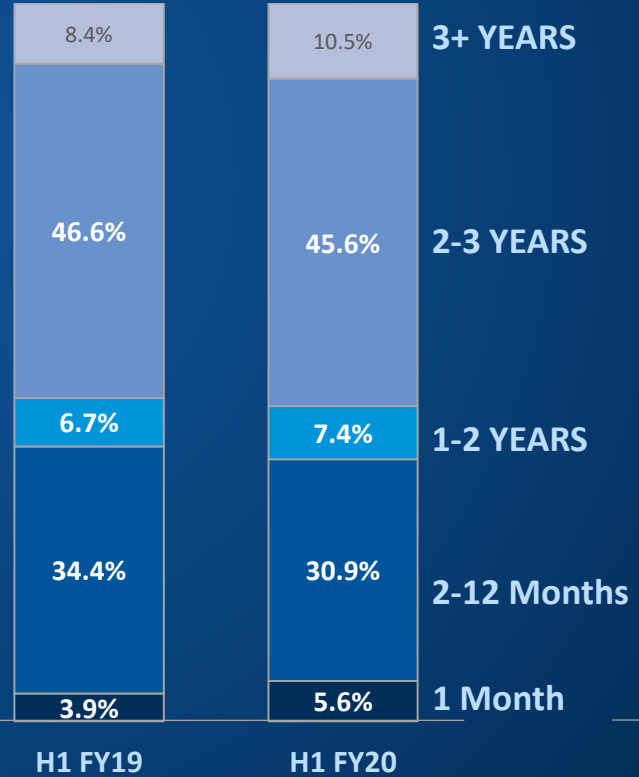
BILLINGS BY CUSTOMER TYPE



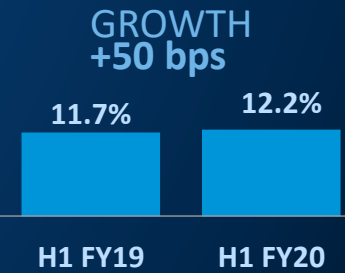
BILLINGS BY SIZE (Employees)



BILLINGS BY LENGTH OF CONTRACT⁽¹⁰⁾



PERCENTAGE OF CUSTOMERS WITH UTM AND ENDPOINT



Weighted average contract length⁽¹⁰⁾ of 26.3 months, a small decrease on 27.2 months in the comparative period

5-Year Renewal Rate

Renewal rate driven by cross-sell

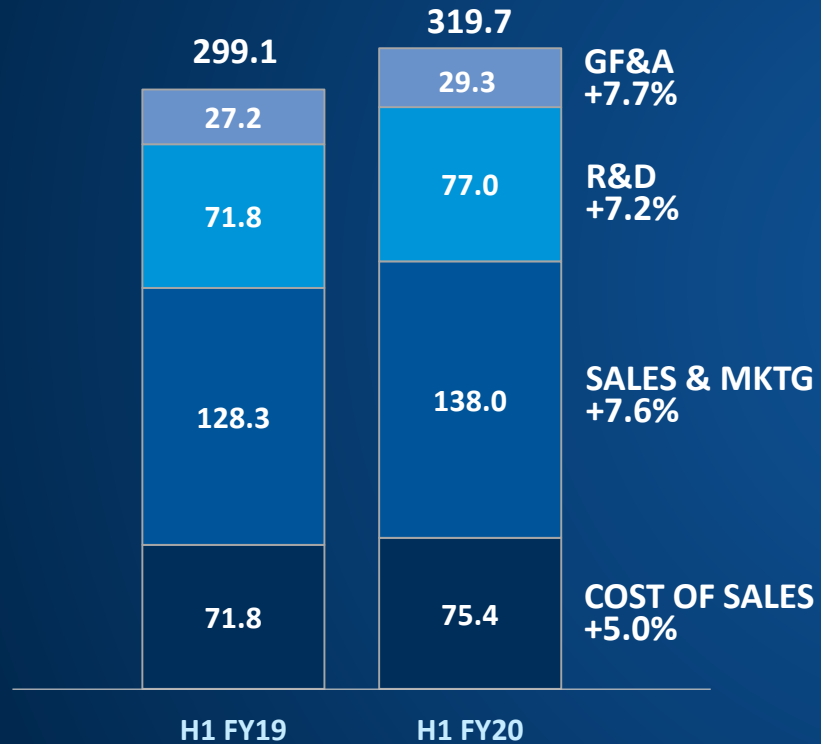


- Renewal rate is difficult to predict as it is an output, particularly affected by levels of cross-sell in the period
- Cross-sell opportunity remains, with current year benefiting from CIX Advanced EDR, MTR, plus Sophos Central management and Synchronized Security on the XG firewall

Expense Performance

Costs as a proportion of billings largely stable; with continued investment in go-to-market

COST ANALYSIS (\$M)⁽¹¹⁾



COSTS AS % OF BILLINGS⁽¹¹⁾



Cash EBITDA and Statutory Income Statement

23.7% increase in CEBITDA; driven from both IFRS 16 impact and underlying trading

CASH EBITDA RECONCILIATION

\$M	H1 FY19	H1 FY20
Cash EBITDA	54.0	66.8
Net deferral of revenue and selling costs	(4.0)	(4.9)
Depreciation	(5.8)	(12.8)
Unrealised foreign exchange loss	5.7	0.3
Adjusted operating profit	49.9	49.4



STATUTORY INCOME STATEMENT

\$M	H1 FY19	H1 FY20
Billings	352.7	372.0
Net deferral of revenue	(3.2)	(6.2)
Revenue	349.5	365.8
Cost of sales	(72.9)	(75.4)
Gross profit	276.6	290.4
Sales and marketing	(131.0)	(136.7)
Research and development	(74.0)	(77.0)
General finance and administration	(27.7)	(29.3)
FX profit/loss	6.0	2.0
Adjusted operating profit	49.9	49.4
Amortisation	(7.8)	(10.3)
Share based payment expense	(20.6)	(20.4)
Exceptional items	5.5	(14.3)
Operating result	27.0	4.4
Net interest expense	(1.0)	(5.9)
Result before tax	26.0	(1.5)
Tax	(15.0)	(6.1)
Result for the period	11.0	(7.6)

Cash Flow

Focused management of working capital and benefit from IFRS 16

ADJUSTED OPERATING PROFIT TO UFCF RECONCILIATION

\$M	H1 FY19	H1 FY20
Adjusted operating profit	49.9	49.4
Net deferral of revenue and costs	4.0	4.9
Exceptional items*	(1.4)	(6.7)
Depreciation	5.8	12.8
Unrealised foreign exchange	(5.7)	(0.3)
Change in working capital	36.4	40.3
Cash tax	(7.5)	(6.6)
Net cash from operating activities	81.5	93.8
Exceptional items*	1.4	6.7
Capex	(11.3)	(10.1)
Unlevered FCF	71.6	90.4

*Excludes non-cash fair-value adjustment on contingent consideration

- **Operating Cash Flow**

Cash flow from operating activities increased by \$12.3 million to \$93.8 million

- **Working Capital**

Focused management of working capital, with DSOs flat YOY at 42 days

- **Capex**

Modest decline in Capex YOY, mainly due to the timing of planned expenditures

- **IFRS16**

Application of new lease accounting treatment also benefited cash flow in the period, excluding this the growth in Operating Cash Flow was 6% YOY

Summary

Kris Hagerman, CEO

SOPHOS

Summary: H1 Performance

- Continued top-line growth in revenue and billings
 - Subscription business remains the key driver
 - Growth across Enduser, Network, new business, and MSP
- Further progress in next-gen transition
 - Customers are better protected with next-gen cybersecurity
 - Clear benefits to business models of our partners, our customers, and Sophos
- Cross-sell billings are supporting subscription renewal rates
 - Sophos Central underpins the cross-sell strategy
 - We continue to innovate: key recent releases include Sophos MTR and Sophos XG Firewall v18 EAP
- We continue to execute on an effective and differentiated strategy

SOPHOS

Cybersecurity evolved.

Q&A

SOPHOS

Impact of IFRS 16

Improvement in measures

IFRS 16 impact statement	H1 FY20			H1 FY19		Growth	
	Reported \$M	IFRS 16 \$M	Excl. IFRS 16 \$M	Reported \$M	Incl. IFRS 16 %	Excl. IFRS 16 %	
Operating result	4.4	(0.7)	3.7	27.0	(83.7%)	(86.3%)	
Amortisation of intangibles	10.3	-	10.3	7.8			
Share-based payments – equity settled	20.4	-	20.4	20.6			
Exceptional items	14.3	-	14.3	(5.5)			
Adjusted operating profit	49.4	(0.7)	48.7	49.9	(1.0%)	(2.4%)	
Depreciation and unrealised FX	12.5	(6.7)	5.8	0.1			
Billings deferral	6.2	-	6.2	3.2			
Related selling costs deferral	(1.3)	-	(1.3)	0.8			
Cash EBITDA	66.8	(7.4)	59.4	54.0	23.7%	10.0%	

- Both the operating and adjusted operating result benefit by the net removal of \$7.4M of lease payments, replaced by \$6.7M of depreciation on the right-of-use asset
- CEBITDA, UFCF and cash from operating activities all benefit from the removal of \$7.4M of lease payments
- An additional \$1.3M interest expense is recognised in the period
- Hence net impact on profit before tax of \$0.6M

End Notes

- (1) Billings represents the value of products and services invoiced to customers after receiving a purchase order from the customer and delivering products and services to them, or for which there is no right to a refund. Billings does not equate to statutory revenue.
- (2) The next-gen product portfolio consists of the Group's most advanced products, managed in Sophos Central, notably including Sophos Intercept X for endpoint protection and the Sophos XG Firewall.
- (3) MSP Billings exclude Reflexion.
- (4) Adjusted operating profit represents the Group's operating profit/(loss) adjusted for amortisation charges, share option charges and exceptional items
- (5) Cash earnings before interest, taxation, depreciation and amortisation ("Cash EBITDA") is defined as the Group's operating (loss) / profit adjusted for depreciation and amortisation charges, any gain or loss on the sale of tangible and intangible assets, share option charges, unrealised foreign exchange differences and exceptional items, with billings replacing recognised revenue.
- (6) Unlevered Free Cash Flow represents Cash EBITDA less purchases of property, plant and equipment and intangibles, plus cash flows in relation to changes in working capital and taxation.
- (7) Constant currency billings excluding OEM.
- (8) Renewal rate calculated as value of contracts renewed in a period / contracts up for renewal in the period. Calculation is at constant currency and includes upsell and cross-sell.
- (9) Renewal base excludes acquisitions and OEM and is at reported exchange rates.
- (10) Constant currency billings.
- (11) Expenses included within the definition of cash EBITDA at actual exchange rates.

SOPHOS
Cybersecurity evolved.