Workiva Q2 2023 Earnings Call

Mike Rost, Julie Iskow, Jill Klindt

Thursday, August 3rd, 2023

Mike Rost

Good afternoon and thank you for joining us for Workiva's second quarter conference call. During today's call, we will review our second quarter results and discuss our guidance for the second quarter and full year 2023. Today's call has been pre-recorded and will include comments from our Chief Executive Officer, Julie Iskow, followed by our Chief Financial Officer, Jill Klindt. We will then open the call up for a live Q&A session.

A replay of this webcast will be available until August 10, 2023. Information to access the replay is listed in today's press release, which is available on our website under the Investor Relations section.

Before we begin, I would like to remind everyone that during today’s call, we will be making forward-looking statements regarding future events and financial performance, including guidance for the second quarter and full fiscal year 2023. These forward-looking statements are subject to known and unknown risks and uncertainties. Workiva cautions that these statements are not guarantees of future performance. All forward-looking statements made today reflect our current expectations only and we undertake no obligation to update any statement to reflect the events that occur after this call.

Please refer to the company’s Annual Report on Form 10-K and subsequent filings for factors that could cause our actual results to differ materially from any forward-looking statements.

Also, during the course of today's call, we will refer to certain non-GAAP financial measures. Reconciliations of non-GAAP to GAAP measures and certain additional information are also included in today's press release.

With that, we'll begin by turning the call over to CEO, Julie Iskow …

Julie Iskow

Thank you, Mike, and good afternoon everyone. During today's call, we'll walk you through our Q2 results and discuss where we're winning in the market across our solution portfolio. We'll also provide our perspective on the current macro environment, highlight exciting new platform innovation, and we'll provide guidance for Q3.

Q2 was another solid quarter. Subscription revenue grew at 21%, driving a beat to the high end of our revenue guidance. Q2 operating margin also beat the high end of our guidance by 222 basis points.

This was my first quarter as CEO. The leadership transition has been smooth and successful. I've had the opportunity to spend a lot of time over the last few months meeting with employees, customers, and partners all around the world. I'm more optimistic than ever in the opportunity in front of us. Despite the challenging macro, I'm confident in our ability to successfully execute our growth strategy and advance our productivity initiatives.

We're winning with assured, integrated reporting. Workiva remains the only platform that brings Financial Reporting, ESG, and GRC together in one secure, controlled, audit-ready environment. This is showcased by the growth we're seeing in our large-contract customers. The number of contracts valued over $100 thousand dollars increased 24%; those over $150 thousand dollars increased 28%; and contracts valued over $300 thousand dollars were up 40% - all compared to Q2 of 2022.

Along with our best-of-breed capabilities, our platform is a strong and key differentiator in the marketplace and it's resonating with our customers.

I'd like to highlight three Q2 expansion deals. All of which are full assured, integrated reporting wins:

- **First**, a Fortune 100 aerospace and defense company purchased ESG to complement their previous investment in SEC, Global Statutory Reporting, and GRC. This 10-year loyal SEC customer was engaged with a Big 4 firm in transforming their ESG program. The Big 4 firm recommended Workiva as the technology of choice and they'll also be providing delivery for the project.
- **Second**, a privately held provider of IT infrastructure and IT products and services expanded their existing investment in GRC and ESG by purchasing a suite of financial solutions consisting of our private company reporting, global statutory reporting, and management reporting. This assured, integrated reporting win was sourced by the same Big 4 advisory firm that delivered the customer's current GRC and ESG solutions. The firm will also be handling the project delivery of this new financial reporting solution suite.
- **And third**, a European-based multinational telecommunications company purchased both our ESG and our GRC solutions to complement their existing investment in SEC and Global Statutory Reporting. This deal was a co-sell win with a Big 4 advisory firm and we will be partnering with them on the delivery of this project.

These examples showcase the value and the flexibility of our innovative platform, and they speak to the value of managing financial reporting, non-financial - or ESG - reporting, and audit, risk and controls all in one platform. They also highlight the important role that our partners play in extending the value of our platform and account expansion

The strength of our partner program continues to contribute both new logos and deal expansions - that are sourced by or a co-sell with a Workiva advisory or technology partner.

Our partner-first strategy is also driving results in ESG. I'd like to highlight a few examples from Q2 where customers invested in and expanded their ESG program with Workiva:

- **First**, a Fortune 500 provider of food, facilities, and uniform services purchased ESG to complement their existing SEC solution. This long-time SEC customer was looking to expand their program in ESG data management, reporting, and climate accounting. This opportunity was influenced by both a regional advisory firm partner and by a climate accounting software partner. The combination of Workiva ESG data management & reporting along with the partner-delivered integrated climate accounting solution will provide this client a comprehensive ESG solution.

- **And second**, a European-based consumer products company was a new logo win with their purchase of ESG. This opportunity was sourced by a Big 4 advisory firm who had been engaged on an ESG transformation project. A driving force behind this project was the customer's future compliance with the new CSRD ESG disclosure requirement. The software selection went through a formal RFP process and Workiva prevailed as the top solution to address this company's ESG reporting requirements.

While non-financial reporting is a new growth driver, we continue to benefit from strong growth in our financial reporting solutions. This portfolio of solutions goes beyond our well-established SEC solution. In Q2, we had signature wins in our vertical-specific solutions for banks, investment firms, and state and local governments. We also saw strong momentum in our private company financial reporting solutions, including those companies on a private-to-public journey.

I'd like to highlight two Financial Reporting deals that closed during the second quarter:

- **First**, a top 20 US city purchased 7 solutions to support their Annual Comprehensive Financial Report. This new logo win was a joint sales pursuit with an ERP technology provider to support a finance transformation project that included a new ERP system. Workiva and this partner submitted a joint proposal and aligned on supporting the city's financial reporting requirements. This opportunity was also influenced by a regional consulting partner who had a previous relationship with the city and this regional partner will be implementing the project.

  Our financial reporting suite of solutions provides significant value to finance transformation and ERP selection projects. The complexity of this type of finance transformation is where our platform truly shines.

- **And second**, we closed a 7-figure solution upsell for fund reporting with a US-based global investment company. This new purchase expands the use of our fund reporting solution across their private equity and credit fund portfolio. The project will be implemented by a regional accounting advisory firm who has implemented two other Workiva solutions for the same client.

I'd like to move on now to talk about our GRC suite of solutions...

With increasing stakeholder scrutiny, establishing an integrated, enterprise-wide governance, risk, and compliance program is a strategic priority for many organizations. At the core, GRC programs include processes for controls, risk, and audit management.

I'd like to highlight two GRC deals that closed during the second quarter

- **First**, we landed a new logo win with a publicly traded consumer products company that purchased controls management to support their SOX process. This deal was brought to us by a Big 4 firm who was advising the client's accounting team on their controls process. Once they saw the power of our control testing capabilities - the deal was locked-in.

- **And second**, a top 15 US-based mutual insurance company expanded their investment in Workiva with Audit Management. This solution will be the sixth Workiva solution purchased and expands on their GRC investment in controls management and enterprise risk management. This opportunity was sourced by a regional advisory firm who implemented the controls and risk management solutions back in 2022.

Now I'd like to shift gears and share our perspective on the macro environment. Not unlike other SaaS companies, we continue to operate through some challenging market conditions. While our top-of-funnel activity is growing, we do see sales cycles extending and customer budgets are under increased scrutiny. And, it's clear from my conversations with both our customers and partners that more executives are involved in decision making, and budgets are tightening. And, that's regardless of company size or industry sector.

Having been a CIO and a buyer of SaaS software for many years, it's my experience that you become more selective and focused on business-critical applications when budgets tighten. So, our focus continues to be on communicating our value and working with our partners to deliver high ROI projects.

We do have some positive news to share on Capital Markets. In Q2, secondary offerings remained strong and we saw an uptick in our IPO activity. We're pleased with how we are competing for these IPO deals that are starting to emerge.

In Q2, we supported the successful IPO of a fast-casual chain of restaurants. This company started out with Workiva through the purchase of private company reporting back in Q2 of 2022. They then purchased Capital Markets in Q1, added on the Workiva SOX solution, and converted to the SEC solution in Q2.

While it is encouraging to see IPO movement, we're not forecasting a measurable comeback in the second half of this year. We are, however, encouraged by our win rates in the larger deals that are going to market.

Another part of the macro environment that impacts Workiva is the fast-paced change in the evolving ESG market. ESG has emerged as an important and sometimes polarizing topic in US politics and it's frequently captured the news headlines. But, even with the ongoing political debate, stakeholder demands for transparent, non-financial data continue to grow louder.

What's clear from our experience working with our corporate clients is that new and pending ESG regulations across the US and Europe are driving the convergence of non-financial and financial reporting, as well as the requirement that the data be audit-ready and investor grade. Other stakeholder groups such as investors, suppliers, consumers, and employees are also requiring greater disclosure of material and non-financial information.

And, as evidenced by a number of ESG-related actions taking place around the world, we still believe there is a generational opportunity in front of us. Here's just a short list of regulations and potential legislation that evolved during the second quarter:

- On June 9th, EFRAG - which is the technical advisory to the European Commission under the CSRD - issued a draft set of enterprise reporting sustainability standards for providing further clarification on this already passed mandate. And on Monday, July 31st, the EU voted on final approval for these reporting standards.
- Next, on June 18, Swiss voters accepted a new law that formalizes Switzerland's commitment to climate protection and adoption of new reporting requirements.
- Then, on June 26th, the International Sustainability Standards Board launched new ESG standards - IFRS S1 and IFRS S2. The ISSB states that the release of these standards will usher in a new era of sustainability-related disclosures in capital markets worldwide.
- On June 27, the Australian government announced plans to implement mandatory, climate-related financial disclosure requirements for companies and financial institutions.

And finally, here in the U.S., there are two important updates:

- **First**, the SEC reported that they are targeting October 2023 to provide further clarity on the Climate Disclosure Rule.
- **And second**, in California, two ESG disclosure bills have passed the senate and are now in committee review in the assembly. These two state bills would require companies operating in California to report their greenhouse gas emissions from across their supply and value chains, and their climate-related risks and both in line with the TCFD.

This list speaks to how the regulatory environment continues to expand globally in both scope and complexity. Regulations are increasing as is the demand for more data and disclosure. This is what we do...and it's why our platform is so relevant.

I'll turn now to R&D and our continuous platform innovation...

We remain focused on innovating and developing new capabilities and furthering the openness and the extensibility of our platform. We believe we are leading a new wave of innovation in which transformative business value will be achieved through a combination of human expertise, contextual data, and the responsible use of Generative AI technology.

Generative AI has the potential to revolutionize the business reporting market by further boosting productivity and efficiency, and by enabling insights that lead to better and faster data-driven decisions.

Our platform's open ecosystem approach will let our customers decide which industry-leading large language model best fits their needs, including those models from Google and Microsoft. Customers will never have to move their data from the Workiva platform to leverage Generative AI and neither Workiva nor our technology partners will store or use customer data to train models. It's a capability that brings together our differentiated technology, data security, and domain expertise.

We'll be discussing Generative AI and we'll be providing a business and strategy update at our 2023 Analyst Day on Tuesday, Sept. 19th, so please mark your calendars. This year's hybrid event will take place in Nashville, TN and also be available via livestream.

We have once again combined our Analyst Day with Workiva Amplify, our annual customer conference. We want to ensure all in-person attendees also have an opportunity to meet with our customers and our partners.

We look forward to seeing you there.

In closing, I'll leave you with a few final remarks.

- Workiva delivered solid second quarter results.
- We're winning with our multi-solution and account expansion strategy, resulting in strong growth in large contract customers.
- We remain confident in the resiliency of our business, the continued demand for our assured, integrated reporting platform, and our ability to expand in our large and relatively unaddressed TAM.
- Notwithstanding the current macro challenges, we remain committed to both our growth strategy and achieving operational leverage.

Finally, I'd like to thank our global team of dedicated employees who continue to execute on our strategy, take care of our customers and each other, and live by our company values. We were honored to be recognized by Fortune which named Workiva on its Best Workplaces for Millennials list. This is our 7th year on the list. Millennials make up almost 70% of our workforce, which is why this award is so meaningful to us.

And with that - I'll now turn the call over to Jill …

Jill Klindt

Thank you, Julie.

Let’s turn to our results. This afternoon I will review our financial performance for the second quarter 2023 and provide Q3 and full year 2023 guidance before opening the line for questions.

As Julie mentioned, we beat our Q2 revenue guidance at the high end primarily due to strong subscription revenue growth.

We beat guidance on Q2 operating results at the midpoint by $3.9 million dollars. Our revenue beat, coupled with productivity initiatives and a reduction in Consulting expenses drove the operating beat. The results of the focus on operating leverage we discussed last quarter is evidenced by improved profitability for the first half of 2023 vs. 2022.

Let's go through some key results and highlights for the quarter. We generated total revenue in the second quarter of $155.0 million, delivering growth of 18% from Q2 2022.

- **Subscription revenue** was $136.8 million, up 21% from Q2 2022. While new logos and account expansions both helped drive strong revenue growth in Q2 2023, 45% of the increase in subscription revenue in Q2 came from new customers added in the last 12 months.

- **Professional Services revenue** was $18.3 million in Q2 2023, relatively flat compared to the same quarter last year. This was consistent with the expectations we outlined in our Q1 call.

As we have discussed, our strategy for professional services is to transition lower margin setup and consulting services to our partners. Part of building a high-performing Partner ecosystem is to provide our partners a strong business opportunity; delivering professional services to our common customer, and promoting the value of the platform. In doing this, we expect setup and consulting services revenue to decline year over year for the full year 2023, which should be mostly offset by our growth in higher margin XBRL services.

Now on to our performance metrics. We added 106 net new customers in Q2 for a total customer count of 5,860, a growth of 479 customers from Q2 2022.

Our subscription and support revenue retention rate remained at a best-in-class 98% for the second quarter of 2023, which is comfortably ahead of our internal objective of 96% or above.

With add-ons, our subscription and support revenue retention rate increased to 111% for the second quarter of 2023 compared to 108% for Q2 2022. This rate improved 190 basis points compared to the first quarter of 2023.

We are very pleased with the increase we are seeing in Net Revenue Retention. A driver of this improvement is the strong account expansion activity we are seeing, led by the addition of new solutions and expanding the use (and spend) for existing solutions. One customer highlight from Q2 was a US Department of Health agency expanding their use of Workiva GRC via their six-figure purchase of our Audit Management solution. This government agency initially purchased our controls management solution in Q1 2021 to support their OMB circular A123 requirement for managing risks and establishing a system to assess, correct, and report on the effectiveness of internal controls.

Account expansions like this are also a strong contributor to the increase in large contract value customers. As Julie mentioned, we continue to see momentum and are optimistic that we can continue to expand the number of customers spending over $100k. In the second quarter of 2023, we had 1,470 contracts valued at over $100K per year, up 24% from Q2 the prior year. The number of contracts valued at over $150K totaled 823 customers in the second quarter, up 28% from Q2 2022. And, the number of contracts valued over $300k totaled 272, up 40% from Q2 2022.

In addition to account expansion, six-figure new logo wins, many of which are sourced by or a co-sell with our partners, are also driving this large contract cohort. A great Q2 example of this is a six-figure, new logo private company financial reporting win with a building products manufacturer. This deal was sourced by a technology consulting partner who will also be providing delivery on the project. This new customer was purchased by Private Equity in 2022 and will be using Workiva to manage more stringent financial reporting requirements.

Moving on to our operating metrics, Gross profit totaled $117.6 million in Q2, up 17% from the same quarter a year ago. Gross margin was 76% in the latest quarter versus 77% in Q2 2022. The decrease is due to higher cloud computing, T&E, and compensation expenses vs Q2 2022.

Operating expenses increased by 8% from Q2 2022. We are pleased with the operating leverage we are seeing. The trend is improving, as operating expense growth is the lowest since 2020, and half the rate of revenue growth year-over-year.

We posted an operating loss of $600 thousand in Q2 2023, a substantial improvement compared to Q2 2022's operating loss of $8.3 million. As we discussed in our Q1 call, we expect improvement in our operating leverage in the second half of 2023. and we are focused on delivering non-GAAP profitability for the second half of 2023 and for the full year 2024.

At June 30, 2023, cash, cash equivalents, and marketable securities totaled $466 million, an increase of $26.4 million compared to the balance at March 31, 2023.

Operating activities in Q2 2023 resulted in cash provided of $26.0 million compared with an increase in cash of $8.7M in the same quarter a year ago. This was a record addition to cash from operating activities. The collection of several large multi-year customer prepays drove the increase in cash in Q2. We do not expect similar accretions to cash but do believe that cash flows will continue to stay positive in the second half of 2023.

Q2 delivered a rebound in our deferred revenue. As discussed in our Q1 earnings call, Q1 was impacted by seasonality in our deferred revenue and the timing of several large contract renewals and contracts with prepayments. Our Q2 deferred numbers reflect that those contract renewals have been completed. Also, our cash flow numbers highlight the impact from a few large contract pre-payments.

Turning now to our guidance… We continue to believe our guidance assumptions are prudent for the current macro environment.

For the third quarter of 2023…

- We expect total revenue to range from $155 million to $156 million.
- We expect revenue growth to be driven by subscription revenue. Q3 services revenue growth is expected to be slightly down vs the same period in the prior year. Growth in higher margin XBRL services should be offset by reductions in setup and consulting services, as we move those towards more partner delivery.
- We expect Non-GAAP operating loss to range from $(1.0) million to break-even, a net income of $0.03 to $0.05 on a per share basis. Our share count will be approximately 54.1 million weighted average shares.

For the full year 2023...

- We are holding our full-year revenue guidance to that reported in our Q1 call, a range from $626 million to $628 million.
- We are raising our guidance for non-GAAP operating loss to range from $(3.0) million to $(1.0) million or a net income of $0.09 to $0.12 on a per share basis. Our share count will be approximately 54.0 million weighted average shares
- As I highlighted earlier, we expect the growth from XBRL services revenue to be offset by a decline in setup and consulting services revenue.

- For the full year 2023, we continue to expect we will post positive free cash flow for the seventh consecutive year.
- We will be non-GAAP profitable in the second half of 2023 and are committed to improved margins for the full-year in 2024. We remain committed to the long-term operating model outlined at our September 2022 Investor Day.

In summary, I want to thank all of our employees and partners for their continued support and hard work.

Before we turn to Q&A, I would like to reiterate three key points:

- **One,** We delivered 21% subscription revenue growth in Q2 and we continue to believe that we can deliver 20% subscription revenue growth for the full year 2023.
- **Two,** We delivered a beat on Q2 operating margin guidance and are focused on continuing the momentum of margin improvement and targeting a Non-GaaP operating profit in Q4.
- **And Three,** We remain committed to our strategy and our long-term operating model.

In closing, I want to echo Julie's thanks to all Workiva employees. You are an amazing team and I am proud to be working beside you. For the analysts and investors listening to our call today, I look forward to seeing you next month at our Investor Day event.

We will now take your questions.

Operator, we are ready to begin the Q&A session.