Appian Q4 and Full Year 2023 Earnings Call Prepared Remarks Transcript

Sri Anantha

Thank you, Operator. Good morning and thank you for joining us to review Appian's fourth quarter and full year 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. You can follow along with our earnings presentation by downloading 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 first 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, please refer to our most recent annual report on Form 10-K, quarterly reports on Form 10-Q, and other filings with the SEC. These documents are also available on our investor 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 over to Matt.

Matt Calkins

Thanks Sri, and thanks everyone for joining us today.

In the fourth quarter of 2023, Appian's cloud subscription revenue grew 26% to $83.1 million. Subscriptions revenue grew by 24% to $115.8 million. Total revenue grew 16% to $145.3 million. Our cloud subscription revenue retention rate was 119% and our adjusted EBITDA was a gain of $1.0 million.

For the full year, Appian's cloud subscription revenue grew 29% to $304.5 million. Subscriptions revenue grew 21% to $412.3 million. Total revenue grew 17% to $545.4 million. Our adjusted EBITDA was a loss of ($44.8) million.

I want to mention two milestones at the top of this call. Last year for the first time, our revenue exceeded half a billion dollars. Second, and an interesting complement to the first observation, we achieved the highest non-GAAP gross margin in our public history last quarter at 78%.

In our presentation deck we've included one last time the special bonus metrics we tracked quarterly in 2023. We didn't get the recession I expected, but there were some macro complications, and you can see it all starting on page 5.

Last year was the year of AI talk. Now the conversation will shift to more tangible things: shipped features, successful deployments, and practical value. That change will be good for Appian.

We have a distinctive approach to the AI market, based on years of leadership and existing tech. We are focused specifically on the application of AI to data. We are leaders in data fabric (which is like a virtual database uniting the customer's enterprise) and we are leaders in AI, and now we will be leaders in the combination of these two things.

I think everyone understands by now that AI is only as good as the data behind it. More data, better AI. Appian has an open data strategy that allows AI to benefit from information scattered across the enterprise. Ask a question and your response will be informed by everything known to the business, not just the contents of one silo. Same for generating new content – the more data that supports the AI, the more sources you bring to bear, the better the output.

Let's explore this with an example. The purpose of this example is to show you the advantage of having AI draw from multiple data sources, that AI is better that way.

We work with a large US state government entity that awards hundreds of millions of dollars in contracts every year using Appian. Its procurement processes are highly regulated and must comply with federal and local laws. In Q4, this organization deployed Appian AI to optimize its awards management process. As you know, contracting usually involves many data objects, of different types, in different formats, typically in many different locations. Now, AI will understand thousands of regulatory and procedural policies from various sources so employees don't have to manually search for information. Appian AI is embedded in the customer's workflow, doing work, and making the customer's data more usable than before. Procurement officers and supporting staff can ask AI questions in real-time and get great answers. This allows them to advance their procurements with speed and accuracy.

Our second advantage is simplicity. Appian takes a practical view towards technology. Our goal isn't just to make extraordinary software, but to make it accessible. Programming in Appian is done with a mouse not a keyboard. We take the same approach to AI. One of the nation's largest universities uses Appian to improve graduation rates. It recently deployed Appian AI to its student advisors. AI will recommend actions to take on student cases and propose meeting agendas to advisors before they meet with students.

First, I want to emphasize how important it is that such a system draw on all the data in the enterprise. If you're trying to help a student complete a 4-year degree, you need to know about all the threats to their progress. You need to know if they're failing any courses – that's in one system. You need to know if they're late on tuition payments – that's in another system. You need to know if they're missing classes – that's in the attendance logs. You need to know if they have friends who recently dropped out – that's someplace else. You get the idea. These are different data sources, and AI needs them all to identify risks and make a good recommendation.

My other point is that such a system needs to be easy to setup and use. Counselors just want to ask a chatbot some questions about their students, not become AI technologists themselves. We made it easy. And it was easy to deploy, as well, going live in under 2 months.

All this talk about drawing on the full enterprise of data sounds great until you consider the implications – merging datasets within the enterprise, uploading massive amounts of data, and training AI algorithms you don't control. Appian requires none of that. We offer insight across the widest amount of data, but we do it while disclosing the least of it. We specialize in Private AI. We use our data fabric to provide just the information that's pertinent for every question, rather than pre-training an algorithm on everything an organization knows. It's more cost-effective, and much more respectful of our clients' architecture and privacy.

Another example to make this point: a top pharmaceutical company manages several core processes with our platform, including ones related to clinical trials and manufacturing logistics. In Q4, the company named Appian its standard enterprise workflow tool. It'll now deploy our platform to over fifty-thousand employees. The company aims to bring new products to market faster. Our AI is privy to their confidential documents, their lab results, etc. This is sensitive work, and needless to say they take the privacy of their data very seriously. This global firm has decided to trust our technology to make the most of what they know while keeping the highest commitment to protecting it.

Appian landed some of our largest seven figure deals this quarter. The total contract value of our top 10 net new software deals increased by 70% in Q4 2023 compared to the same period last year. Here are some notable stories. A US military branch wants to unify its operational systems so it can better mobilize its forces. Appian will integrate data from 14 legacy systems into a single modern platform. In Q4, it purchased a seven-figure software deal. One hundred thousand analysts will use Appian to help train, manage, and equip personnel globally.

In another example, a financial services company managing hundreds of billions of dollars in assets became a new customer in Q4 with a seven-figure software deal. The company is growing quickly and wants to modernize legacy systems that are too costly to maintain. Appian’s data fabric will unify data from over a dozen core systems into a single view so it can run end-to-end workflows like customer onboarding and wire transfer. Appian will help the customer scale and process more than 4 million transactions annually.

Next, a national police force recently adopted new strategic priorities to optimize operations and improve public safety. In Q4, it selected Appian as an enterprise-wide platform to improve productivity and unify the group’s disparate systems -- starting with an incident management app. Desk workers will triage inbound requests, open cases, and route them to field officers for investigation. This process had always been manual. Now, thousands of officers will be able to respond to incidents faster using Appian.

Last example now. A top health insurance provider is running a company-wide initiative to modernize systems and save $1 billion. It selected our platform to aid this effort, starting with its enrollment process. The provider made a seven-figure software deal in Q4 and became a new customer. Appian’s data fabric will consolidate Medicare and Medicaid requests into a single application so employees can do eligibility checks, fix discrepancies, approve applications, and initiate the billing process. The organization expects to process millions of requests annually on Appian.

Now, a few final notes. Appian expanded our credit facility this quarter with participation from existing and new lenders. The aggregate principal amount of the term loan facility is now $200 million (up from $150 million), and the revolving credit facility is $100 million (up from $75 million). We welcome the additional financial strength.

Appian has made progress in our intention to aim high in this market and sell more large deals. We've held to our financial discipline and done so without taking anything from growth. You'll hear more about our plans at our investor meeting on April 16th at Appian World in Washington, D.C. We'll talk strategy, results, technology, AI, and more. I hope to see you there.

With that, I'll hand the call to Mark.

Mark Matheos

Thanks, Matt. I'll review the financial highlights for the quarter, and then will provide guidance for Q1 and the full year 2024.

We closed 2023 on a strong note with revenue and adjusted EBITDA coming in above the high end of our guidance range. We saw continued healthy contribution from existing customers and strong growth from key industry verticals. Let's go into the details.

Cloud subscription revenue was $83.1 million, an increase of 26% year-over-year, and above guidance. On a constant currency basis, cloud subscription revenue grew 23% year-over-year. Total subscriptions revenue was $115.8 million, an increase of 24% year-over-year. On a constant currency basis, total subscriptions revenue grew 21% year-over-year.

Professional services revenue was $29.5 million, down 9% year-over-year. As previously noted, services revenue can be volatile from quarter to quarter, and a few large projects can influence performance. Our professional services will continue to be a strategic offering, focused on enabling partners and driving customer success. Long-term, we expect professional services revenue to continue to decline as a percentage of total revenue.

Subscriptions revenue was 80% of total revenue, compared to 74% in the year ago period and 76% in the prior quarter.

Total revenue was $145.3 million, an increase of 16% year-over-year and above our guidance range. On a constant currency basis, total revenue grew 13% year-over-year.

Our cloud subscription revenue retention rate was 119% as of December 31, 2023, up from 115% a year ago and 117% in 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 36% of total revenue, compared to 34% in the year ago period.

Our cloud software net new ACV bookings were approximately 80% of the total net new software bookings in 2023, consistent with last year's mix.

Now, I'll turn to our profitability metrics. Non-GAAP gross margin was 78%, compared to 73% in the year ago period, and 75% in the prior quarter.

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- Subscriptions non-GAAP gross profit margin was 91%, compared to 90% in the year ago period and 89% in the prior quarter.
- Professional services non-GAAP gross margin was 26%, compared to 27% in the year ago period and 30% in the prior quarter. As noted on prior earnings calls, we continue to invest in Customer Success management. These advisors help our customers achieve the most from our technology and increase adoption of our platform. As a result, professional services non-GAAP gross margin should decline to the low 20% range in 2024 and beyond.

Total non-GAAP operating expenses were $114.1 million, down 4% from $119.1 million in the year ago period.

Adjusted EBITDA was a gain of $1.0 million, versus our guidance of a loss between $(16.1) million and $(12.1) million, compared to an adjusted EBITDA loss of $(24.8) million in the year ago period.

In the fourth quarter, we had approximately $11.1 million of foreign exchange gains, compared to $8.5 million of foreign exchange gains 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 income was $4.9 million or $0.06 cents per diluted share, compared to non-GAAP net loss of $(20.6) million or $(0.28) cents per diluted share for the fourth quarter of 2022. This is based on 75.3 million diluted shares outstanding for the fourth quarter of 2023 and 72.7 million diluted shares outstanding for the fourth quarter of 2022. As noted above, fourth quarter 2022 non-GAAP net loss was aided by $11.1 million in foreign exchange gains or a gain of $0.15 cents per share, which was not included in our original guidance.

Now, before I turn to the balance sheet, I wanted to briefly update on the recent amendment to our credit agreement. On February 12, 2024, we increased the aggregate principal amount of the term loan facility by

$50 million, and the limit of the revolving credit facility by $25 million. The total aggregate term loan facility is now $200 million, and the revolving credit facility is $100 million. Additional details on the terms of the financing will be in the 10-K filing.

Turning to our balance sheet, as of December 31, 2023, cash and cash equivalents and investments were $159.0 million, compared with $196.0 million as of December 31, 2022. For the fourth quarter, cash used by operations was $(8.2) million versus $(12.6) million for the same period last year.

Total deferred revenue was $240.7 million as of December 31, 2023, an increase of 20% 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 large 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.

I'll now recap our full year 2023 results. Cloud subscription revenue was $304.5 million, representing 29% growth year-over-year. On a constant currency basis, cloud subscription revenue grew 26% year-over-year. Total subscriptions revenue for the year was $412.3 million, an increase of 21% compared to 2022. On a constant currency basis, total subscriptions revenue grew 19% year-over-year. Professional services revenue was $133.0 million, an increase of 4% compared to 2022. Total revenue was $545.4 million, up 17% compared to 2022. On a constant currency basis, total revenue grew 15% year-over-year. Adjusted EBITDA loss was $(44.8) million compared to $(76.0) million loss in 2022.

Non-GAAP net loss was $(59.2) million in 2023 or a loss of $(0.81) per diluted share compared to non-GAAP net loss of $(89.2) million or a loss of $(1.23) per diluted share for 2022. This is based on 73.1 million and 72.5 million diluted shares outstanding for 2023 and 2022, respectively.

For the year ended December 31, 2023, cash used in operations was $110.4 million versus $106.6 million for the same period last year. Adjusting for the one time payment of $57.3 million in the third quarter of 2023 for the judgment preservation insurance policy, 2023 cash usage showed a substantial improvement versus 2022.

As a reminder, we continue to believe cloud subscription revenue is a better indicator of our business momentum than billings or remaining performance obligations (or RPO). 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 first quarter of 2024, cloud subscription revenue is expected to be between $84 and $86 million, representing year-over-year growth of 21% and 23%. Total revenue is expected to be between $148 and $150 million, representing year-over-year growth of 9% and 11%.

Adjusted EBITDA loss for the first quarter of 2024 is expected to be between $(9) and $(5) million. Non-GAAP net loss per share is expected to be between $(0.21) and $(0.16) cents. This assumes 73.5 million diluted weighted average common shares outstanding.

For the full year 2024, cloud subscription revenue is expected to be between $364 and $366 million, representing year-over-year growth of 20%. Total revenue is expected to be between $615 and $617 million, representing year-over-year growth of 13%.

Adjusted EBITDA loss is expected to be between $(25) and $(20) million. Non-GAAP net loss per share is expected to be between $(0.73) and $(0.66). This assumes 73.8 million diluted weighted average common shares outstanding.

Our guidance assumes the following:

- First, Q1 professional services revenue will decline by a low double digit rate YoY. For the year, we expect professional services revenue will be flat or will decline by a low single digit rate compared to a year ago.
- Second, on-prem license revenue will grow YoY by a mid-single digit rate and will track to seasonality that is consistent with prior periods.
- Third, our Q2 adjusted EBITDA loss will be bigger than Q1's adjusted EBITDA loss. This is due to the combination of on-prem license seasonality and the cost of running our global user conference, Appian World.
- Fourth, total other income and interest expense will be approximately $3 million in Q1 and $15 million for the full year 2024.
- Fifth, capital expenditures will be between $2 and $3 million in Q1 and between $10 and $12 million for the full year 2024.
- Finally, our guidance assumes FX rates as of February 13, 2024.

In conclusion, we are pleased with the performance this quarter. We are investing in growth opportunities that drive long-term value and optimizing costs to drive profitability. We continue to balance our cost profile to prioritize investments in R&D, innovation, CSM coverage, and strategic go-to-market areas such as global partnerships, demand generation activities, and targeted sales capacity.

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