08 - 02 - 2023

JFrog Ltd.

Second Quarter Fiscal 2022 Financial Results Conference Call

JFrog Ltd.

Second Quarter Fiscal 2022 Financial Results Conference Call

CORPORATE SPEAKERS:

Jeffrey Schreiner
JFrog Ltd.; VP of Investor Relations
Shlomi Ben Haim
JFrog Ltd.; Co-Founder, CEO & Chairman of the Board
Jacob Shulman
JFrog Ltd.; CFO

PARTICIPANTS:

Noah Herman
JPMorgan Chase & Co; Research Analyst
Unidentified Participant
Morgan Stanley; Unknown
Kingsley Crane
Canaccord Genuity Corp.; Analyst
Brad Reback
Stifel, Nicolaus & Company, Incorporated; MD & Senior Equity Research Analyst
Michael Cikos
Needham & Company, LLC; Senior Analyst
Jason Ader
William Blair & Company L.L.C.; Partner & Co-Group Head of Technology, Media and Communications
Koji Ikeda
BofA Securities; VP & Research Analyst
Michael Turits
KeyBanc Capital Markets Inc.; MD & Senior Analyst
Jonathan Ruykhaver
Cantor Fitzgerald & Co.; Senior Research Analyst
Robbie Owens
Piper Sandler & Co.; MD and Senior Research Analyst

PRESENTATION:

Operator^ Ladies and gentlemen, thank you for joining us. And welcome to JFrog's Second Quarter 2023 Earnings Conference Call.

I'll hand the conference over to Mr. Jeff Schreiner, VP of Investor Relations.

JFrog Ltd.

Second Quarter Fiscal 2022 Financial Results Conference Call

Jeff, please go ahead.

Jeffrey Schreiner^ Good afternoon., And thank you for joining us as we review JFrog's second quarter 2023 financial results which were announced following market close today via press release.

Leading the call today will be JFrog's CEO and Co-Founder, Shlomi Ben Haim; and Jacob Shulman, JFrog's CFO.

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, including statements related to our future financial performance, including our outlook for Q3 and the full year of 2023.

The words anticipate, believe, continue, estimate, expect, intend, will and similar expressions are intended to identify forward-looking statements or similar indications of future expectations.

You are cautioned not to place undue reliance on these forward-looking statements, which reflect our views only as of today and not as of any subsequent date.

Please keep in mind that we are not obligating ourselves to revise or publicly release the results of any revision to these forward-looking statements in light of new information or future events.

These statements are subject to a variety of risks and uncertainties that could cause actual results to differ materially from expectations.

For a discussion of material risks and other important factors that could affect our actual results, please refer to our Form 10-K for the year ended December 31, 2022, filed with the SEC on February 9, 2023, which is available on the Investor Relations section of our website and the earnings press release issued earlier today.

Additional information will be made available in our Form 10-Q for the quarter ended June 30, 2023, and other filings and reports that we may file from time to time with the SEC.

Additionally, non-GAAP financial measures will be discussed on this conference call.

These non-GAAP financial measures, which are used as measures of JFrog's performance should be considered in addition to, not as a substitute for or in isolation from GAAP measures.

Please refer to the tables in our earnings release for a reconciliation of those measures to their most directly comparable GAAP financial measures.

A replay of this call will be available on the JFrog Investor Relations website for a limited time.

With that, I'd like to turn the call over to JFrog's CEO, Shlomi Ben Haim.

Shlomi?

Shlomi Ben Haim^ Thank you, Jeff. Good afternoon, everyone. And thank you for joining us.

I'm happy to report that JFrog second quarter revenue exceeded our prior guidance, driven by increased cloud consumption, expansion of our security solutions and continued adoption of the JFrog Software Supply Chain Platform. Our 2023 second quarter revenue was $84.2 million, reflecting 24% year-over-year growth. Cloud usage continued to accelerate as we expected, delivering revenue of $27.6 million, increasing 44% year-over-year. We also exceeded our profitability guidance with a non-GAAP profit of $12.1 million, while still investing in our core teams.

Customers with ARR over $100,000 grew to 813 compared to 647 in the year ago period, increasing 26% year-over-year. Customers with ARR over $1 million increased to 24 versus 17 in the second quarter of 2022, up 41% compared to the year ago period. These results reflect that the JFrog Platform continues to be prioritized as critical infrastructure and that our 3 pillars of DevOps, Security and IoT hold strategic value for our customers.

Let me expand on what made Q2 another strong quarter for JFrog. Let's begin with the ongoing adoption of JFrog Security Solutions. Most organizations recognize the need for multiple DevSecOps capabilities such as software composition analysis, contextual analysis, infrastructure's code security, leak secret detection and container security among other key features that are included in JFrog Advanced Security alongside other JFrog offerings.

As we noted in our previous call, we have ambitious goals to provide end-to-end security across the software supply chain with a comprehensive set of capabilities bundled together as a consolidated solution. We believe this approach will outpace and displace point solutions in the market. I'm pleased to report that in the short period since the availability of JFrog Advanced Security in the market, we already gained tens of customers that have added this capability to their subscriptions, indicated that enthusiasm for advanced security is gaining momentum in the DevSecOps market, not only because of the advanced scanners and automation of software packages, but also the native integration with Artifactory that serves our customers as their single source of record.

On that note, I'm excited to mention our recent security product release. As we know, in our industry, over time, less and less software is being written as original code. And instead, binaries are being brought in from the outside world, often open source. Many industry estimates now that up to 90% of software is comprised of open source packages, containers and more, all binaries. Developers often cache public repository to obtain these libraries from the Internet to speed development and as critical features. While developers may be faster, these practices can unknowingly add security and compliance risk in the form of vulnerabilities entering the organization. This creates friction between developers who want to move fast and security teams who don't want to compromise and requires a clear understanding of the software's composition and dependency management.

In partnership with our community, we built JFrog Xray and advanced security as tools integrated natively with Artifactory to protect the software supply chain and everything happening within the organization. JFrog has now shifted even further left to build a fence around companies to automatically and seamlessly stop malicious packages and unvalidated open source licenses from ever entering the organization. I'm proud to announce the general availability of JFrog Curation, which was released a few weeks ago in mid-July. This solution automates the curation of open source software entering an organization before the development process begins.

JFrog Curation automatically checks for malicious components and policy-violating software and prevents them from ever entering the organization and compromising security of the software supply chain. Policies can be defined centrally by security teams and apply at global scale across organizations. Many of our customers are already exploring JFrog Curation, and we look forward to partnering with them. JFrog Curation is offered as a basic add-ons to the Enterprise X or Enterprise Plus subscriptions. Our goal is to enable JFrog users to gain the highest level of

visibility and control over the software development life cycle by delivering a consolidated solution that focuses on all of an organization's binaries. We will continue to bring innovative security solutions to the market and couple them with Artifactory, which already serves millions as the database of DevOps. JFrog Curation joins the security suite of products offered by JFrog, all of which are available in hybrid and multi-cloud versions.

Next, I want to address customers' expansion and tooling consolidation on the JFrog Platform. The complete software supply chain flow is the flow of binaries, which uniquely positions JFrog as mission-critical for every enterprise. As customers continue to streamline their operations with our platform, we see them consolidating tooling around the binary centric pipelines for both DevOps and Security. For example, one of the Fortune 100 top 5 health care pharmaceutical and retail companies made a decision in Q4 of 2022 to migrate away from Google's container management cloud services and Sonatype Nexus binary repository to the JFrog platform, consolidating the complete package management, development pipeline solutions and container registries under one platform.

Only a few months later, in Q2 of this year, they successfully completed the proof of concept with our team as they began to explore consolidation of their multiple security point solutions. As a result of this proof of concept, the customer decided to move away from [SNC] to JFrog to cover the software composition analysis needs and are now exploring JFrog's other security capabilities as part of a strategic consolidation and standardization around JFrog's Platform. We believe tooling consolidation will continue to be both a macro trend and a DevSecOps tooling imperative. This type of consolidation and ROI for our customers reflects the findings of a recent study conducted by Forrester commissioned by JFrog, the Forrester TEI report found that enterprises investing in the JFrog Platform could expect a nearly 400% ROI across 3 years and that some organizations could expect to save up to 156 hours per developer per year when utilizing JFrog's DevOps and security platform.

In this study, an enterprise with thousands of developers could potentially save tens of millions of dollars in costs over 36 months. These results reflect JFrog's core business value of improving efficiency and productivity across an organization through automation and control of the binary flow. At the same time, Forrester noted in another recent industry report that quote, JFrog is great for enterprises that place high value on software supply chain security. Customers are looking across their portfolios to discover ways to reduce technological and integration costs, and the JFrog platform allows them to fulfill this vision.

I now want to focus on ongoing adoption of the JFrog platform across our 3 cores and high-value enterprise subscriptions. When JFrog first entered the market, DevOps was not even free. When we introduced Xray as our first security solution a few years ago, DevSecOps was in its infancy. And today, we see the developers and development organizations are tasked with security, multiple programming languages, cloud-based technologies, multi-cloud deployments, open source management, software distribution and more. With a number of connected devices that must stay updated growing into the tens of billions software truly has no boundaries.

We continue to see customers trusting JFrog with its boundless software delivery. For example, a leading biopharmaceutical company turned to JFrog to help them revolutionize medical supply processes with an innovative approach. Using a combination of software and connected devices, they aim to simplify how hospital and medical staff consume and trade organic and inorganic medical inventory. Looking to guarantee the security and integrity of the extensive network of [cell phone] driven devices in the field, they first consider JFrog Connect for their over-the-air software update and a fleet management solution. However, upon realizing the benefits of JFrog Artifactory as a universal binary repository and JFrog Xray and advanced security for mitigating software supply chain attacks. They decided to adopt JFrog's platform as their system of record. Partnering with JFrog helps them to consolidate around the single DevOps and DevSecOps platform, and we look forward to working with companies such as this moving forward to change the way every industry thinks of delivering and managing software from developers to the secured distributed edge.

Now I would like to address JFrog's view of the potential impact of generating artificial intelligence technologies within our software supply chain platform, security solutions and for individual developers. As we have previously noted, from a business perspective, we believe that AI powered creation of software will drastically increase the overall code created within organization. And that's leading to an increase in the number of binaries being generated by developers or machines. And JFrog continues to be the gold standard in enterprise architect management. We look forward to helping companies scale with our software supply chain platform alongside their AI-driven advances. More code equals more bills, more bills equals more binaries, which creates a huge opportunity for JFrog.

We also see JFrog as an AI enabler for our customers. We already observed JFrog Artifactory serving the repository for customers, machine learning and AI models. Machine learning models are yet another form of binary and consume in the organization as software packages. Therefore, managing customers' AI processes and they'll make a data at scale locally, natively,

alongside other technologies generates incremental benefit from the use of the JFrog platform. The builders of AI models within companies are often Python developers and data scientists utilizing Conda or [Siren] packages already natively supported by Artifactory. This reinforces JFrog as the single source of tool for company's development processes as well as potentially their AI and ML ops initiatives.

Finally, regarding AI within JFrog, we are exploring several approaches that will enhance future versions of JFrog DevOps and security solutions, and we look forward to providing updates on our progress in the near future.

With that, I'll turn the call over to our CFO, Jacob Shulman, who will provide an in-depth recap of Q2 financial results as well as update you on our guidance for Q3 and for fiscal year 2023. Jacob?

Jacob Shulman^ Thank you, Shlomi, and good afternoon, everyone. During the second quarter, total revenues were $84.2 million, up 24% year-over-year. Our stronger than expected revenues in the quarter was driven by continued strength of our cloud business and adoption of higher subscription tiers across the JFrog Software Supply Chain Platform.

In the second quarter, our cloud business saw sequential expansion in customer usage equaling revenues of $27.6 million, up 44% year-over-year. While we continue to see a slower pace of cloud migrations compared to the prior year, we are pleased with improving usage trends during the first half of 2023. Going forward, we believe cloud optimization will remain an ongoing exercise with the large enterprises as customers continue to focus on efficient growth. We reiterate our baseline cloud growth rate of mid-40s during fiscal year 2023.

Self-managed revenues on-prem were $51.8 million, up 17% year-over-year during the quarter. Overall expansion and revenue growth within our self-hosted business remains constrained relative to prior years as customers transition towards cloud and hybrid deployments, which has reduced organizational focus on future expansion within self-hosted deployments. We have received positive feedback from customers regarding JFrog Advanced Security and initial interest in JFrog Curation with many of these engagements being self-hosted deployments. We remain optimistic that our security solutions can be a potential catalyst to reaccelerate revenue growth and customer expansion within our self-hosted business.

Net dollar retention for the 4 trailing quarters was 120%, a decline of 4 points sequentially due to ongoing macro headwinds and lower retention within our self-hosted business. We have started seeing stabilization of NDR around these levels and continue to expect our Net Dollar Retention for the year to be around 120%. Our gross retention continued to be 97% with no change in overall customer churn terms. In Q2, 45% of our total revenue came from Enterprise Plus subscriptions, up from 36% in Q2 of 2022, an increase in revenue contribution of 56% year-over-year.

Now let me discuss our income statement in more detail. Gross profit in the quarter was $70.4 million, representing a gross margin of 83.6%, essentially flat with a year ago period and in line with expectations as economies of scale and cost control offset high cloud revenue contribution. Operating expenses for the second quarter were [$62.2 million], down $1 million sequentially, equaling 73.9% of revenues compared with $58.8 million or 86.8% of revenues in the year ago period.

During the second quarter, we benefited from timing of certain expenses being pushed into the third quarter. We continue to remain focused on expense discipline while continuing to strategically invest in go-to-market initiatives and technology innovation. Our operating profit in Q2 was $8.2 million or a 9.7% operating margin compared to an operating loss of $2 million or negative 3% operating margin in the prior year due to better-than-expected cost efficiencies. Second quarter net income equaled $12.1 million or $0.11 per diluted share based on 108 million diluted shares outstanding versus a year ago net loss of $2.2 million, equating to a loss of $0.02 per diluted share.

Turning to the balance sheet and cash flow. We ended the June quarter with $470 million in cash and short-term investments up from $443 million as of December 31, 2022. Cash flow from operations was $16.7 million in the quarter. After taking into consideration CapEx, free cash flow was $16.2 million, generated a [19.3%] free cash flow margin. We reiterate our expectations for low double-digit free cash flow margins in fiscal 2023. As of June 30, 2023, our remaining performance obligations totaled $213.6 million.

Now I'd like to speak about our guidance for the third quarter and full year 2023. Our full year 2023 expectations continue to estimate strong growth in our cloud business and ongoing expense discipline. For Q3, we expect revenue to be between $87 million to $88 million, with non-GAAP operating profit between $6 million to $7 million and non-GAAP earnings per diluted share of $0.08 to $0.09, assuming a share count of approximately 110 million shares. I would

note that third quarter operating expenses will include costs related to our employee merit increases and our swampUP User Conference, which will cause a sequential step-up. For the full year of 2023, we anticipate total revenue in the range between $343.5 million to $345.5 million. Non-GAAP operating income is expected to be between $24 million and $25 million. And non-GAAP earnings per diluted share of ~~$0.26 to $0.28~~ ($0.31-$0.33 – revised in 8-KA), assuming a share count of approximately 110 million shares.

Now let me turn the call back to Shlomi for some closing remarks before we take your questions.

Shlomi Ben Haim^ Thank you, Jacob. We continue to believe that JFrog is well positioned to achieve our planned growth in the coming quarters, and our customers' ongoing commitments and partnerships alongside us validate the mission-critical nature of our platform.

Before we close, I want to thank the entire JFrog's team for a strong quarter. Your resilience and passion is stronger than any macro headwinds and the results speak for themselves. Q2 success belongs to you.

I also want to invite everyone to attend our Annual swampUP DevOps and DevSecOps User Conference in San Jose on September 13.

I'm looking forward to updating the community on our major products and strategy announcements alongside amazing industry and JFrog customers stories from companies like Fidelity, Riot Games, Netflix and others.

Thank you all for joining us for our Q2 earnings call and may the probe be with you.

Now we'll be happy to take your questions.

Operator?

Operator^ (Operator Instructions) We'll take our first question today from Pinjalim Bora, JPMorgan.

Noah Herman^ This is Noah on for Pinjalim. Just wanted to double-click a bit on the recent curation add-on feature you just recently rolled out. Can you just elaborate on how this has

helped me shift more or less in the DevSecOps life cycle? And are you now targeting a potential different buyer as you sort of roll out the [SNC] product?

Shlomi Ben Haim^ Hi, Pinjalim, yes, and we are very excited about the release of JFrog Curation. Actually, that was part of the plan of expanding our DevSecOps solution and shift even further less as mentioned. The buyers of JFrog Curation are actually a combination of the CIO office and the CSO office. The developers would like to have an automated way to enforce policies that are coming from the CSOs. And by that, to avoid having each of the caching from public hubs of software binaries to get into the organization and to automate this tool process. So basically, it's a partnership between the CSO and the CIO. And still, this demand came from the DevOps and the DevSecOps engineers, so not yet really a few security stakeholder, but the combination of both.

Operator^ The next question comes from Sanjit Singh, Morgan Stanley.

Unidentified Participant^ This is [Chris Cantero] on for Sanjit. Congrats on the results. I wanted to ask around the disparity between the slower kind of 100,000 customer adds versus the 1 million-plus customer adds, I think, was your best ever. So just trying to square both of those would be really helpful.

Jacob Shulman^ Yes, I will take this question. So our goal is to expand all customers, and we see diversification of the customers between different segments. So specifically to expansion of million dollar customers, what we're happy to see is that these customers actually come in from industries that kind of outside of our traditional strong segments, technology and banking, those coming from other industries. And it just shows that the DevOps and DevSecOps capabilities that we offer important across multiple industries.

We also see that our Enterprise Plus platform and subscription continues to provide a lot of value. You're absolutely right that in absolute number of -- in Q3, we added less than prior quarter. However, we see a lot of engagements over the last 12 trailing months, it's comparable to prior periods. So we really don't see any change in the trends here. It's probably just more like a timing issues.

Unidentified Participant^ Got it. Makes sense. And then I also want to ask around kind of the optimization that you're seeing around JFrog Cloud type of customers. Any kind of more clarity

you can give there and maybe kind of where we are in terms of timing and maybe what inning we are with those optimizations?

Shlomi Ben Haim^ Yes. As we noted on our prepared remarks, we continue to see expansion of our usage products by our customers. Previously, we noted that we started the year like January was very slow and still subject to optimization. Then in March, we did see the pickup in usage, which trend continued in April and throughout the quarter. So we believe that those initial headwinds of optimization behind us. Going forward, we do expect that customers will continue to put emphasis on efficient growth. But in terms of usage, we do our customers using more cloud platform. And therefore, we expect that our cloud revenues will continue to grow in mid-40s throughout the year.

Operator^ Next up is Kingsley Crane, Canaccord.

Kingsley Crane^ So I'd like to ask about duration. I think one of the most interesting aspects of it is that it is focused around developer velocity. Obviously, your platform appeals to all kinds of stakeholders, but I think in terms of an individual product, this is one of the more exciting ones for developers. So how do you think that will play out in terms of encouraging adoption? And then are you thinking this a little more drive upsell in the premium bundles or gain more revenues through pricing [a la carte]?

Shlomi Ben Haim^ Yes. So thank you, Kingsley. Curation, in terms of the adoption will increase the usage of JFrog security solutions, the holistic software supply chain security comes as an option, as an add-on to the Enterprise X and the Enterprise Plus subscriptions. And it's, as mentioned, a by seat by year model. So we are expecting to see the expansion coming from the adoption of JFrog Curation as well, not only by the number of Enterprise Plus and Enterprise X users, but also by the number of developers in the organization, in the enterprise that we use.

Kingsley Crane^ Okay. That's very helpful. And then one on the financials. So I want to talk about NRR. So I think that 120% is a great number. But if NRR is a trailing 12-month metric, I think declining 4 percentage points in one quarter is significant. So I think that would suggest that the end quarter performance was well below. So I guess, does that imply a reacceleration or a higher NRR in the back half in order to reach 120% for the full year?

Jacob Shulman^ Yes. So you're absolutely right, Kingsley, that our Net dollar Retention rates declined 4% from prior quarter. It was actually in line with our expectations. If you recall, when

we guided the year, we did expect our Net dollar Retention to go down to around these levels. Currently, we're seeing stabilization around this levels and expect to finalize, finish the year with NRR around these levels.

Operator^ Brad Reback from Stifel is up next.

Brad Reback^ Great. Jacob, on the cloud consumption trends, did July look a lot like June? Or did it actually continue to accelerate?

Jacob Shulman^ Brad, I don't have year-to-date for July, I cannot comment. During the month, we continue to see strong performance, but I don't have final numbers for July.

Brad Reback^ Got it. No problem. And then, Shlomi, I think last quarter, you talked about the global partner network and the momentum you were seeing there. And I don't -- I'm not sure if I missed it earlier in the prepared remarks, but any commentary on sort of rest of the world would be great.

Shlomi Ben Haim^ Yes. That's a good point. Our partners and alliances program continue to accelerate. Actually, I mentioned swampUP User Conference happening on September 13. For the first time, we are also having a partner there day before to celebrate and to enable the over 100 partners that in the past year, we've built the program with. Aside of that, the co-sell and co-marketing motion of working with all 3 clouds, AWS, GCP and Azure is also accelerating through the marketplace. So we are very pleased to see it not only by cloud growth, but also self-hosted partners and not only self-hosted partners, but also by region, by geography and not just DevOps, but also new security partners that joined the portfolio.

Operator^ Mike Cikos from Needham & Company has the next question.

Michael Cikos^ I just wanted to cycle back to Jacob's earlier comment around the NRR. I think it was that we expect to finish the year around this current level. And really, where I'm going with this is that I'd just like to see what gives you the confidence to see JFrog finishing the year at these levels? Is it based on maybe the tone of conversations with customers, the renewal base that you have coming due? Just anything there would really be incremental.

Jacob Shulman^ Yes. So when we think about our net dollar retention forecast, first of all, we're looking at the renewals with our customers and obviously talking to them and evaluating their

plans. We're also seeing continued consumption trends on SaaS and commitments of our annual customers on SaaS. And finally, we're looking at kind of overall economic environment and demand environment, and we see stabilization in that regard, and that's what gives us the kind of analysis of the pipeline and analysis of the opportunities that's in front of us for the second half of the year. That's what gives us confidence that the net dollar retention will stay around this level.

Michael Cikos^ Great. And also, I appreciate the commentary around the customers that are adopting advanced security as well. I think a lot of us are excited about that offering. Can you help us through how your sales force or your go-to-market effort is driving awareness within your existing customer base to drive adoption? And I guess, what has -- what has been some of the early findings from those customers who have adopted, at least, as you think about feedback and building up those customer testimonials to drive additional success around advanced security.

Shlomi Ben Haim^ Yes, Mike. So just as you, we are also very excited about the results. To remind the public, we announced JFrog advanced security full hybrid availability in the first quarter of this year and to see so many of our customers are showing interest in some of them. Tens of them already paid for additional subscription. Obviously, these are great news for us.

The main thing that our go-to-market team is focusing on is to map the renewals that we have ahead of us and see who are the Xray customers that already uses JFrog [fill one] security, Xray software composition analysis and also then, obviously, the capabilities that JFrog advanced security suite offer. And the second effort goes to the market education, so attracting new customers, some of them were mentioned in the call today that are coming to JFrog mainly because of the consolidation. So they want to start and see one software supply chain that not only provide one capability or two capabilities to secure your DevOps and DevSecOps team, but also the repository, the distribution process and everything around that.

So these are the main 2 catalysts called the adoption. The fact that it's also available in the cloud and on-prem gives us obviously the freedom to operate in different deployments environment. So that's a plus as well. And the last thing is that since we are very transparent with our road map, we are speaking about Xray and JFrog advanced security as available in the market in the last quarter. But now we added Curation. So really what we see from our customers is a demand for a holistic one-stop shop for their software supply chain security that also includes future road map items that also help us to build the pipeline.

Michael Cikos^ That's great to hear. I really appreciate the commentary, Shlomi.

Shlomi Ben Haim^ Thank you.

Operator^ Your next question is Jason Ader, William Blair.

Jason Ader^ Jacob, question for you. I'm just trying to figure out what's going on in Q4 with your guidance, because you guided to $0.28 -- $0.26 to $0.28 for the full year. But you're at -- if my numbers are correct, you're at basically $0.25 for the first 3 quarters based on your guidance for Q3. So that implies Q4 would have like $0.03 of earnings and that would be the lowest of the year. Can you talk us through what's going on there?

Jacob Shulman^ So our actual results for the year for the first 6 months are about $0.17, plus about $0.08 to $0.09. So it's about $0.24. So I think if you look at the operating profitability, we expect operating profitability in Q4 to be comparable, slightly higher than in Q3. And I expect that the EPS for Q4 probably going to be in the kind of same levels comparable to Q3. So I hope that makes...

Jason Ader^ But that math doesn't work. I mean, because if you say $0.27 is the midpoint for the full year, and you just said $0.25 for the first 3 quarters, right, then that would imply $0.02 for Q4. So maybe there's something going on below the line in Q4, but I get the operating income trends and it looks like that's continuing to be pretty healthy, but Q4 EPS looks like it would be quite a bit below where the rest of the year has been. So I mean, we can move that off-line if you want, but I just wanted to flag that.

Jacob Shulman^ Thank you for your notes, and I don't expect any outstanding items below the line in Q4.

Jason Ader^ Okay. All right. And then maybe, Shlomi, I wanted to follow up on the last question just on the go-to-market side for security. I guess, what are you guys learning about the go-to-market side for security and how that might be different for some of these packages that you are now offering for security that is different than what you've had to do in the past in terms of go-to-market?

Shlomi Ben Haim^ Yes. So regarding security, what we see is that it's a bit different. First of all, when it comes to DevOps, the bottom-up mechanism is very popular. Usually, it's being adopted by developers or DevOps engineers and scale up by the size of the PO, maybe to the CTO or the CIO and so on. Maybe strategic decisions are being taken top down, like, let's say, migration to the cloud. But most of what we've seen and what -- most of what we have built was from the ground up.

In securities, it's a bit different. The decision is first being taken by the security leaders and then apply in the different groups of the company. What we also see -- and this is quite interesting. We start to see a partnership between the CIO and the CSO, when it comes to software supply chain security. On one hand, the CIO, the VP R&D, they want to be super-fast. The security guys are trying to catch up with it. So any kind of automation that applies into the software supply chain is obviously helping those two to bridge their need. So we usually meet more than 1% of 1 PO when it comes to security. Most of it would be top-down. And most of it -- most of these opportunities will take more than the average quarter or 4-month cycle to complete.

Jason Ader^ Great. And then is -- are the budgets -- usually the CECL has its own budget pool versus the CIO and the developer teams. So is that creating friction because you have to actually tap in to do 2 different budget pools?

Shlomi Ben Haim^ So the strategy that we chose is a strategy of consolidating all the security solution into -- not all of them, but the majority of the security solution from the [gear] scanning to the binary scanning to the distribution, to consolidate it with the capabilities like secret detection, like software composition analysis. We discussed in the call the displacement of SNC, the displacement of Sonatype. Those where displaced by consolidation to a platform. Usually, when this is happening, there is a budget already marked by the CECL and it's being compared to a security tool they already have. If there is a new capability like JFrog Curation, obviously, it will be discussed to start with the CIO and then they would probably bring the security stakeholders.

Jason Ader^ Okay. Just to clarify. That's very helpful, Shlomi. So just to clarify, the security tools that are sold into the DevOps tool chain, are those part of the kind of CIO's budget? Or are those part of the CECL budget? Or is that just depends on the company?

Shlomi Ben Haim^ Exactly. It depends on the company in the enterprise. Most of what we saw, over 80% of the opportunities that we deal with a combination of discussion with both the CSO

office and the CIO office. And we were also very pleased to see that in some organizations, big one, including leading financial institutes or retail, the CIO and the CSO offices were already merged into one.

Operator^ Your next question is Koji Ikeda, Bank of America.

Koji Ikeda^ A couple from me. Just kind of going back to Curation. You mentioned earlier of a seat-based model. So how do you think about the TAM for Curation? Is it all the developers out there, security folks, ops folks, I mean, is it all of them? How do you think about the TAM?

And then the second part of the question on Curation is because of seat-based, where is it going to show up in the revenue recognition? Is it going to be in subscription self-managed to start and eventually break it out? Just trying to understand where it will fit, so we could begin to understand where it's contributing to growth.

Shlomi Ben Haim^ Yes, Koji, I'll take your first part of the question, then Jacob can elaborate more about where it will be recognized. The TAM of JFrog Curation is very much aligned with the TAM of the DevSecOps market. Actually, we are after the opportunity to cover all the developers from outside the organization. So the reason that there is an alignment between the value and the way we price it is that it goes by the number of developers that consume software packages from outside the organization. So let's say that you go to a public repository and you want your software supply chain to be curated from the get-go, it will be multiplied by the number of developers that are consuming this service.

And obviously, with the combination of Artifactory and JFrog advanced security that sits on top of Artifactory and secure your software supply chain from inside the organization, there is an alignment between the model. So it's basically all organizations are now using -- based on researchers, 90% of the software that is being made in the world is coming from open source initiatives, software this is being cached from outside the organization, and therefore, it's relevant to all the organizations by the number of developers and so on. So we are looking at the same time.

The second thing, so it's -- at the same time with a bigger market share. The second thing around that is obviously the fact that the competition with this solution is completely different than the DevSecOps market that is very fragmented. There are not so many Curation solution out there that are putting a fence between the organization and the public hub and preventing

you from bringing the Log4j, the [network4j] from the get-go. So it's not just the TAM, it's also what is the size of the market share that we can grab by having this solution embedded to our platform.

Jacob Shulman^ And with regards to the split between deployment types, it would be really since it's an add-on to existing subscriptions that will be dependent on the main subscription that the customer subscribes for it. But if it's self-managed, then it will be reported as self-managed, if it's a SaaS, it will be reported as SaaS.

Shlomi Ben Haim^ And by seats in both cases.

Koji Ikeda^ Got it. Now, that's super helpful. And then one follow-up here, if I may. I wanted to ask about the $1 million customers and the $100,000-plus customers. You added $3 million ARR customers, which is the most, I think you've ever added in the quarter sequentially. So congratulations there. With the $100,000 maybe a little bit light versus recent quarters. So just trying to understand the dynamics between the $1 million-plus and the $100,000-plus?

Jacob Shulman^ Yes. So Koji, when we are looking at it, obviously, we are very pleased not only because of the size of the deal, but also the subscription that these guys are upgrading to and the amount of capabilities from the JFrog platform that they are actually using while we are monitoring it. In the last 6 quarters, we added at least $1 million customers to this group, which also demonstrate an adoption or a growing adoption of our platform. Regarding the over $100,000 customers, the 813. I'm looking at it, if I may, in a different perspective to add over 150 customers to this group. In the last year, during the recession, with all the new technologies that are coming and all the changes that we see in the market, I actually -- I'm pleased with the growth. And I'm expecting it to grow even higher than that when I'm looking at the pipeline and hoping to see the changes in the market.

Operator^ Your next question is Michael Turits, KeyBanc Capital Markets.

Michael Turits^ Shlomi and Jacob, good job on the quarter. You said that your -- the optimization is largely behind you. Microsoft and some others have talked about there being several quarters still to go on optimization. So can you maybe describe what might be different in terms of your cycle around optimization with some of the hyperscalers? And this could be an overlapping question. What's going on in terms of new projects and whether or not they're beginning to bound new software development projects?

Shlomi Ben Haim^ Michael, I will take this question. I think big hyperscalers provide multiple different types of different workloads. And it's hard for me to comment what kind of work was impacted by optimization was what not. What we've seen is that the DevOps continues to be critical infrastructure. And we see that in terms of data transfer and storage, we continue to see growth sequentially in -- on our systems. So it's really, maybe the difference between what we've seen and what hyperscalers see is that the fact that they provide a variety of different workloads, maybe that's what impacts their kind of picture.

Michael Turits^ So just another qualitatively then why does it make sense that your optimization would have troughed, if you will, and started to rebound earlier than theirs from anything. And again, obviously, I'm not asking you to comment on their business, but it's a broad business where you're seeing -- it seems like an earlier rebound.

Jacob Shulman^ Yes. As we previously discussed, we monetized our SaaS deployments by data transfer and storage and storage more low-hanging fruit, which we did see those optimization efforts accelerated about in Q3 and Q4 of last year. Those were kind of more shorter time to optimization, data transfer optimization is typically more longer kind of efforts required. Sometimes it doesn't even make sense to -- for customers to focus on that because it required significant engineering effort. So what we believe is that customers will continue to monitor their usage. They will continue to strive to grow efficiently, but the initial impact of optimizations we believe behind us.

Shlomi Ben Haim^ Michael, I'll add to it. It's Shlomi here. There is just much that you can dry out your infrastructure reservoirs. With everything that comes in, the security automation, software supply chain is getting enriched and also need to deal with AI, as we mentioned. Some of our customers already started to use our infrastructure as the infrastructure for AI. This can be optimized up to a limit. And as Jacob mentioned, not necessarily can be compared to the big cloud companies. And we hear our customers telling us. Some of them are also on pending mode, waiting for budget to be released, so they will be able to migrate to the cloud and grow even faster.

Operator^ Next up is Jonathan Ruykhaver, Cantor Fitzgerald.

Jonathan Ruykhaver^ So GitHub recently claimed that approximately 46% of its customer's code is already written by Copilot. They actually said they expect that to go to 80% sooner

rather than later. They've also made some comments on the lines, the Copilot has accelerated customer growth and is making GitHub more competitive around managing get repositories. Now to your comments earlier, Shlomi, it seems fairly obvious that LLM will drive increasing market need for Artifactory management broadly. But how do you see the competitive impact playing out due to LLM, what is your strategy there?

Shlomi Ben Haim^ Yes. Well, that's a great question. And as you know, there are a lot of discussions around AI and the regulations around AI and the panic around AI and the potential of AI and opportunity of AI. But let's kind of take it to the level that everybody understands more code, whether it's made by Copilot or by developers, creates more binaries and more binaries create more opportunities for JFrog because we are the standard makers in the binary storage of the organizations today. Not only that, the most exciting thing about managing AI models and ML-Ops models is the fact that they are yet another form of binary. So whether you handle it or you build it inside the organization or you bring it from outside your organization, Artifactory can be the only tool that supports you unless you just want to dump it on a regular file server.

The last thing that I would say is that these coders that you mentioned that are using Copilot to build AI are basically Python developers or data scientists that are using packages like Conda and [Siren]. All 3 of them are already natively supported in Artifactory. So for them, it's just a familiar place that they are going to, to fetch their model and not just the AI models, but also the models that are coming with AI to train the machine. So we see big opportunities around that. As we mentioned in our call, we are looking forward to share with the industry, what we build natively to support this demand. And as it goes back to the previous question, infrastructure optimization will get to a limit that from that point on, it will get back to what we used to see in the previous years.

Jonathan Ruykhaver^ Okay. So I think what you're saying, Shlomi, is the opportunity is really around the ability of Artifactory to support all these AI models, which are just another form of a binary and that just broadens the opportunity for JFrog, right?

Shlomi Ben Haim^ Artifactory is almost a default solution for that. When I asked ChatGPT about it, that's the question I got. So that's the most authentic way for me to validate that. And the other thing is Xray because you don't just want to have the dummy storage. You also want to have the right tool to enforce the policy before you bring any type of models from public repositories of AI. So you want a tool like Xray that would say that if this AI model is coming

with their own licenses, it cannot get into the organization. And that protects your software supply chain. You need tools like Curation to block it from the get-go. So the proxy will not be subject to any type of malicious code or open source license violation. So the one solution of JFrog is set to grab the fulls of this opportunity.

Operator^ Next up is Rob Owens, Piper Sandler.

Robbie Owens^ Great. I want to drill down a little bit again into the cloud optimization being behind you. And I don't know if you've ever broken out for us the difference in gross retention rates between self-hosted and subscriptions. And is there something in those trends that may show you that a lot of the optimization is behind you at this point, either from a gross or net retention perspective because I guess that might play into some of those questions around net retention for the back half of the year?

Jacob Shulman^ Yes. We -- the only information of [lot color] that we provided on the difference between SaaS and self-hosted is that SaaS net dollar retention is higher than corporate and self-hosted is lower than corporate. Again, we believe that the storage optimization is kind of low-hanging fruit, and those who wanted to do that most likely have done that because we started seeing first optimization efforts about 4 quarters ago. And that's sufficient time for customers to look at the storage environment and make necessary steps. For the data transfer optimization is -- we believe it's going to be ongoing effort. And that's why we said the first wave of optimization is behind us and going forward, we'll be just seeing more efficient growth of our customers.

Operator^ There are no further questions at this time.

I'll turn the call back to Shlomi for closing remarks.

Shlomi Ben Haim^ Thank you all for joining us on this quarter earnings call, and thank you for your questions.

We are looking forward to keep executing and delivering more news from the swamp. Join us at swampUP, September 13 in San Jose. And by then, may the probe be with you.

Thank you.

JFrog Ltd.

Second Quarter Fiscal 2022 Financial Results Conference Call

Operator^ This concludes today's call. Thank you for attending. You may now disconnect.