Workiva Inc

2014 Fourth Quarter and Full Year Results Conference Call

March 11, 2015

CORPORATE PARTICIPANTS

Matt Rizai, Chairman and Chief Executive Officer

Stuart Miller, Executive Vice President, Treasurer and Chief Financial Officer

Adam Rogers, Investor Relations Manager

PRESENTATION

Operator:

Good afternoon. My name is Chris and I'll be your conference Operator today. At this time, I would like to welcome everyone to the Workiva Incorporated Q4 and Full Year Results Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question and answer session. If you would like to ask a question during this time, simply press star, then the number one on your telephone keypad. To withdraw your question, please press the pound key. Thank you.

Adam Rogers, Investor Relations Manager, you may begin your conference.

Adam Rogers:

Thank you and good afternoon, everyone, and welcome to the Workiva Fiscal 2014 Fourth Quarter and Full Year Earnings Conference Call. This afternoon, we'll begin with comments from Chairman and Chief Executive Officer, Matt Rizai, followed by Executive Vice President, Treasurer and Chief Financial Officer, Stuart Miller, and then we'll turn the call over to questions. Also on the line today are Marty Vanderploeg, President and Chief Operating Officer, and Mike Sellberg, Executive Vice President and Chief Product Officer.

A replay of this call will be available until March 18th. Information to access the replay is listed in today's press release, which is available on our website under the Investors section. As a reminder, today's conference call is also being broadcast live via webcast.

Before we begin, I'd like to remind everyone that on today's call, we will be making forward-looking statements regarding future events and financial performance, including our guidance for the first quarter and full fiscal year 2015. 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 obligations 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 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 earnings press release.

With that, we'll begin by turning the call over to our Chairman and CEO, Matt Rizai.

Matt Rizai:

Thank you, Adam, and thanks to everyone for joining us today on this call as we report our fourth quarter and full year 2014 financial results. The fourth quarter capped a great deal for Workiva and our Wdesk productivity platform, delivering strong revenue growth.

Our total revenue for the quarter was $30.1 million, up 28% over fourth quarter of 2013. For full year 2014, we generated total revenue of $112.7 million, up 32% over the prior year. Workiva ended 2014 with 2,261 customers, including more than 65% of the Fortune 500 and Fortune 100 companies. Our revenue growth was due to increase in market share in the SEC compliance market while gaining customers, seats (ph) and uses cases in our non-SEC market. In fact, non-SEC grew at a faster rate than SEC in 2014, which is a trend that we expect to continue in 2015.

Beyond SEC compliance, we saw strong demand in 2014 in Sarbanes-Oxley compliance and management reporting, as well as in risks and fiscal reporting in the financial services sector. We believe that the market for SOX – this is Sarbanes-Oxley – compliance is considerably larger than the SEC market and our revenue in our first quarter—quarter selling our SOX solution grew at a rate similar to the growth we saw in the first few quarters of selling our SEC solutions.

We also saw strength, as I mentioned, in management reporting, which encompasses a wide range of business data collaboration use cases, including board reporting, monthly operation reviews and SG&A, just to name a few. The other area of growth was in financial services, including banks, in insurance companies and in (inaudible) management companies that continue to find new cases for Wdesk, including ORSA, which is own, risk and solvency assessment, DFAST, which is Dodd-Frank Act stress testing and fiscal reporting.

Customer adoption of our Wdesk platform continues to grow, driven by our customers' organic use of our solutions across their enterprises and by our sales and marketing efforts that drives awareness and adoption of our solutions. We believe we are well positioned to capitalize on our nearly $7 billion addressable market opportunity, and we are optimistic that we can create a large reoccurring revenue stream over time.

Overall, our results demonstrate our continuous solid execution and value we've delivered to our customers. We have users who tell us that if their employees stop buying Wdesk, then they will quit their job. Wdesk is that valuable to our customers.

Stuart Miller, our CFO, will spend more time going through our financial results and performance metrics shortly, but before he starts, I would like to spend just a few minutes telling our story to those who are not yet familiar with Workiva. This is our first conference call as a public company. As you know, we completed our Initial Public Offering in December 2014. The IPO provides us with greater resources to invest in our growth initiatives and also helps to further increase our market awareness. I want to thank our past investors, and I also want to thank and welcome our new shareholders.

There is an explosion in the amount of data that enterprises need every day. Approximately 90% of the data is unstructured or residing outside of ERP systems in various locations and formats. At the same time, regulation is increasing, which drives additional risks and costs of producing meaningful reports on a timely basis. For companies with employees spread across the globe, collaboration and accountability becomes even more difficult.

Legacy systems and technology that rely on error prone manual processes are ineffective at helping executives leverage their business data to make real-time decisions. Accuracy and efficiency have become mission critical. Our Wdesk Productivity Platform transforms how companies collect, manage, analyze and report their rapidly growing volume of business data. Wdesk includes integrated word processor, spreadsheet and presentation applications built upon our data management engine. With our patented live linking technology, data only needs to be entered once and is instantly updated throughout Wdesk with a full audit trail, saving time and improving accuracy. Wdesk allows multiple users to simultaneously author, review and publish data link documents and reports. Wdesk helps our customers mitigate risk with more control and productivity than ever before.

In March 2013, we released Wdesk to meet strong customer demand for our flexible, collaborative, daily productivity platform. Wdesk expands our solution set from SEC reporting to many solutions that we market today, which include compliance, risk, sustainability and management reporting and enterprise risk management. These solutions encompass many use cases. We target large opportunities by identifying significant business data challenges that companies face across many industry verticals. We then market and deliver solutions that solve those critical business pain points. The value we deliver to our customers is validated by our 96% customer satisfaction score, our high revenue retention rate and our net promoter score of 74.

So how do we grow our business currently, and how do we plan to drive continuous solid growth in the future? There are two main parts of our growth strategy. First, our sales and marketing teams will continue to sell our proprietary technology platforms and solutions to new Wdesk customers. Today, we serve over 2,200 organizations in nearly every industry. With more than 34,000 target organizations in our addressable market, we believe we have just scratched the surface in terms of market penetration.

Second, we expect to generate growth by extending the use case, use of Wdesk throughout our current customers' organizations by adding new users for existing solutions, as well as selling more solutions to our customers. As I mentioned previously, the success we're having with Wdesk for staff compliance is a great example of how we are executing on our growth strategy. Today, we have more than 100 organizations, including Advance Auto Parts, FirstMerit Corporation and Gulfport Energy Corporation use Wdesk to increase efficiency and documenting, implementing and assessing internal controls over financial reporting as required under SOX. We estimate the addressable market for SOX is over three times the size of opportunity for SEC reporting, which is the primary driver of our growth today. SOX is that much bigger because the number of co-workers who work with SOX compliance linearly grow with the size of the company.

In addition, there are a large number of companies that manage internal controls under SOX guidelines because both private and public companies follow these protocols. A great way to illustrate how SOX is driving our land-and-expand strategy is to look at a customer use case. FirstMerit Corporation started using Wdesk to file its 10-K with the SEC but soon adapted Wdesk for a broader range of solutions. FirstMerit has grown its number of Wdesk seats (ph) by more than five times for employees who use Wdesk for SOX compliance, including COSO framework magic (ph); COSO is for Committee of Sponsoring Organizations. FirstMerit relies on Wdesk Live Linking to ensure internal control information is consistent across documents and departments.

In addition to SOX compliance reporting, we see strong demand in the financial services market for risk reporting, which includes capital planning, resolution and recovery plans, stress testing and internal risk assessment. We have customers with hundreds of employees collaborating on documents that are over tens of thousands of pages long. Wdesk's ability to collect and link business data inside one version with granular (ph) control and a full audit trail provides enormous value to heavily regulated industries such as financial services.

Increasing Wdesk functionality is another way we're expanding within our client base to capture solid growth opportunities. For example, now we have more than 100 customers that are using Wdesk Data Collection, which provides a secure and efficient way to bring critical information from across organizations into a single source of trusted business data. At the Whirlpool Corporation, for example, 120 from—people from multiple departments use Wdesk Data Collection to securely gather, aggregate and manage unstructured and structured business data. Each Whirlpool region saved approximately 75 hours per quarter by eliminating administrative non-value added processes.

Over time, we also expect to increase our footprint in Europe, where the growth drivers for our solutions are similar to those in the US and Canada. For example, we see significant opportunities in Europe for Wdesk to be used to document, implement and assess internal controls over corporate financial reporting, which are similar to Sarbanes-Oxley compliance in the US. In addition, sustainable reporting is now mandatory for large companies in Europe, so we see a growing need for business data collaboration and streamlined corporate reporting.

In summary, our fourth quarter was strong. We're excited by the breadth of the opportunities that our proprietary technology platform, attractive business model and strong competitive position provide us as we further our expansion and continue to drive long-term shareholder value.

With that, let me turn it over to Stuart Miller, our Chief Financial Officer. Stuart?

Stuart Miller:

Thank you. As Matt mentioned, we're pleased with our results for the fourth quarter and full year. I'll begin by reviewing our fourth quarter and fiscal year 2014 results, and then I'll comment on our first quarter and full year 2015 financial outlook. Thereafter, we'll open up the call to your questions.

We generated total revenue in the fourth quarter of $30.1 million, representing an increase of 28% from the fourth quarter of 2013. Broken down by reporting segment, subscription and support revenue was $25 million, up 31% over the prior year period. Professional services revenue was 5.1 million, a 16% increase of from the fourth quarter in 2013.

Before running down the P&L, let's turn to supplemental measures. We ended 2014 with 2,261 customers, a net increase of 334 customers from year end 2013. For the month of December 2014, our subscription and support revenue retention rate was 97%, which we believe demonstrates the power of our platform and the excellence of our customer service teams. Our retention rate provides a high level of visibility and predictability into future revenue and cash flows. Customers being acquired or ceasing to file SEC reports continue to be the largest contributing factors to attrition, reflected in our revenue retention rate. With add-ons, our subscription and support revenue retention rate was 104.1% for the month of December compared with 108.4% in September 2014.

Here is some context for understanding the change. Our quota carrying sales force is divided into three groups, hunters, farmers and hybrids. The majority of our sales force hunts for new logos. Our farmers manage existing accounts and make add-on sales. In April 2014, we began shifting the focus of our farmer teams towards new use cases with larger target deal sizes, such as Sarbanes-Oxley compliance and risk reporting. As we expected, the time devoted to training our farmer teams and the redirection of our farmer teams' attention toward new decision makers at our customers affected add-on revenue recognized in the fourth quarter of 2014. Focusing our farmer teams on these new, higher ACV (ph) use cases is the right strategic move for us. In fact, we had good success selling SOX and risk reporting in the fourth quarter to our existing customers, but given our subscription revenue model, the impact is largely absent from the December 2014 retention rate with add-ons since most of these new contracts didn't start generating meaningful revenue until January 2015.

Moving down our P&L, I will talk about our results before stock-based compensation; in other words, on a non-GAAP basis. We show a reconciliation to GAAP in the press release, which is available in the Investors section of our website at workiva.com.

First, I'll address cashed-based incentive compensation, an expense item that relates to headcount, so it spreads across four line items, cost of revenue, R&D, sales and marketing and G&A. Accruals for cash-based incentive compensation in Q4 2014 totaled $3.7 million versus $1 million end of Q4 2013. Post-IPO, we shifted more incentive compensation to cash instead of stock. In Q4, the $2.7 million additional accrual equated to 880 basis points in expense. Going forward, we expect the accrual for incentive compensation to be more evenly distributed throughout the year.

Gross profit was $20.3 million in the fourth quarter, up 19% from the prior year period, and represented a gross margin of 67.5%. Subscription and support gross profit was 19 million or 76% of subscription revenue compared to 15 million or 78.4% of subscription revenue in the fourth quarter of 2013. The higher accrual for cash incentive compensation and higher salaries accounted for substantially all of the fourth quarter reduction in gross margin on subscription and support.

Professional services gross profit was 1.3 million or 25.9% of professional services revenue compared to 2.1 million or 48.5% of professional services revenue in the same period last year. The decline in our professional services gross profit reflected hiring and training additional consultants ahead of our first quarter seasonal peak. Managing seasonal demand for services is a challenge and we decided to increase hiring and training in the second half of 2014 in anticipation of managing to a more sustainable utilization rate during our seasonal peak in the first quarter of 2015.

Turning to operating expenses, R&D expense in the fourth quarter was $11.6 million, an increase of 36% from 8.5 million in the prior year's fourth quarter. The (audio interference) as well as higher compensation expense. Sales and marketing expense increased 34% in the quarter to 13.7 million. The increase in sales and marketing expense was driven primarily by additional headcount, as well as increased advertising expenses to address the significant market opportunities for our expanded Wdesk solutions and use cases.

General and administrative expenses were 4.8 million, an increase of 34% compared with 3.6 million in the prior year's fourth quarter. Higher headcount, compensation and professional fees used to support our operation as a public company account for the increase in G&A expense.

Operating loss was 9.8 million compared with an operating loss of 5.2 million in the prior year's fourth quarter. Net loss was 10.8 million for the fourth quarter of 2014 compared to a net loss of 5.1 million in the prior year period. Non-GAAP net loss per share was $0.33 in the fourth quarter of 2014 compared to $0.16 in the prior year period.

Now I will recap our full fiscal year 2014 results. Total revenue was $112.7 million, up 32% year-over-year. Subscription and support revenue was 91.3 million, increasing 40% over 2013. Professional services revenue was 21.4 million, up 7% from prior year.

Moving down to P&L and again focusing on non-GAAP expenses, gross profit was $79.7 million, rising 31% year-over-year and representing a 70.7% gross margin. Operating loss was 31.2 million compared with a loss of 25.9 million the prior year. Net loss was 33.8 million in 2014, and net loss per share was $1.05, which compares to a net loss of 26.2 million in 2013 or $0.83 a share.

Turning to our balance sheet and our statement of cash flows, at December 31, 2014, we had cash and cash equivalents of $101.1 million compared to 18 million as of December 31, 2013, and 20.3 million as of September 30, 2014. Net cash used in operating activities was 3.5 million in 2014 and we invested 8.6 million in capital expenditures in that year. In 2013, Workiva used 10.5 million of cash in operating activities and invested 9.5 million in cap ex.

There's one additional item I'd like to mention. In the course of preparing our audited financial statements for 2014, we identified and corrected a non-material error related to our accounting for reimbursements received pursuant to a government jobs training program. This correction was not material to any of our annual financial statements and had no impact on reported revenue or total cash flow in any period. The correction related solely to the timing of the recognition of reimbursement we received for government jobs training program. The correction increased our previously reported net loss for the first nine months of 2014 by $143,000. Details of this correction are summarized in Table 2 of the appendix to our press release and are summarized in Note 2 to the audited financial statements that is included in our Form 10-K which we filed this afternoon.

Now I'd like to finish with our guidance for 2015 and our guidance on non-GAAP loss from operations and non-GAAP loss per basic share, excluding the impacted of stock-based compensation. You can see the reconciliation, the guidance on GAAP numbers in the press release. For the first quarter of 2015, we expect total revenue to range from 33.5 million to $34 million. We expect non-GAAP operating loss to range from $6.7 million to $7.2 million. GAAP operating loss is expected to be in the range of 9.1 to $9.6 million. We expect non-GAAP net loss per share to range from $0.18 to $0.20. GAAP loss per share is expected to be in the range of $0.24 to $0.26, and our loss per share guidance assumes 40 million basic shares outstanding.

For the full fiscal year 2015, we expect total revenue to range from 139 to $142 million. We expect non-GAAP adjusted operating loss to be in the range of 37 million to 40 million. GAAP operating loss is expected to range from 48 million to 51 million. Non-GAAP adjusted net loss per share is expected to be in the range of $0.92 to $1.00 a share. GAAP loss per share is expected to range from $1.19 to $1.27. Again, our loss per share guidance for the full year assumes 40 million shares outstanding.

I also want to talk about prepaids, which show up on our balance sheet as deferred revenue. We expect change in deferred revenue in the first quarter of 2015 to be relatively flat compared to December 31, 2014.

Starting in the second quarter of 2015, we will be implementing two shifts in policy on prepaids that will effect change in deferred revenue. First, we've reduced incentives for long-term contracts so that we can capture more margin. Second, for new customers, we're standardizing to a one-year contract and will apply an upcharge to any new customer who wants to sign a quarterly contract. We plan to extend this policy to contract renewals in the third quarter. With these changes in policy, we expect the change in our deferred revenue balance year-to-year to grow approximately half the amount it grew in 2014.

In summary, Workiva had a solid fourth quarter from both a financial and operating perspective, demand remains robust for our solutions and we will remain focused on executing our strategic growth plan to capitalize on our multi-billion dollar market opportunity.

With that, we would now like to take your questions. Operator, we're ready to begin the Q&A session.