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Q4 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Henri Kiili

Investor Relations & Treasury Director, F-Secure Oyj

I'm Henri Kiili, responsible for Investor Relations at F-Secure. Today, we have our CEO, Juhani Hintikka here; and CFO, Eriikka Söderström. They will give the presentation, but remember, throughout the presentation, you can submit questions in the webcast portal. Please state the questions in English.

But now, stage is yours, Juhani.

Juhani Hintikka

President and Chief Executive Officer, F-Secure Oyj

Thank you, Henri. Good afternoon, everybody. Good afternoon from the cold and wintery Helsinki, where you can feel the chill walking in here. A pleasure to be here. This is my first quarterly and at the same time, annual report to you. It's been a while since I've been doing this, but feels good to be back, nevertheless.

Before I start, let me just say that this has been an unusual year for everybody, but especially at our company, I would like to thank the employees. We've clearly had a tough year and unusual year, but I'm very proud of the way we have handled the year and pull-through as a business and as a community.

Our first priority as a company was to ensure the health and safety of our employees. A lot of the work during the invisible work, if you like, has been around to ensuring the health and working conditions of the people. And one clear example of that has been, for example, the ability to scale our remote working capability.

As a natural second thing, it has been important to ensure full business continuity to our customers. The customers pay our bills, and of course, it's been important that we keep our eye on the ball and focus on their business and their ability to cope with this situation. It is fair to say that our businesses for both corporate customers and consumers alike have shown their resilience.

Nevertheless, we are not immune or have not been immune to the pandemic. Our consulting business has experienced a negative impact. That has typically been, of course, a business where personal encounters, face-to-face meetings, personal relationships play a big role. And we saw clearly a negative impact throughout the year.

At the same time, we have recovered. If we look at our past performance in Q4, we're already showing signs of good recovery and positive momentum going forward. This has, of course, been helped by the fact that us, but

also our customers have actually become accustomed to the remote delivery that we've been able to offer throughout the year 2020.

The market has also been active. In our market, we look at the cyber criminals and we look at the way they have operated. And clearly, we've seen an uptick in – with the increased attacks we have seen and that has, of course, kept us busy, protecting our customers and protecting the businesses. But overall, as we said in the beginning, it has been an unusual year, but we had a solid ending for it, and all of our businesses are set for a successful 2021.

Let's move forward and have a look at how the year looked in perspective. And starting from the left side, here in this graph, we are showing the revenue split and growth by businesses. You may recall that we break down our businesses with cybersecurity consulting, corporate products and consumer security, and on the left bar you see the 2019 figures, the pale blue is the consumer security where we had the revenue of €94.8 million in 2019. And here, we saw a sharp increase, breaking the €100 million barrier for the first time, really good strong performance from our consumer business.

On the corporate product side, plus 2% growth. At the same time, as we will discuss later on, this doesn't tell the whole truth, because we did have a very strong order intake in corporate products. But for the reason of having that as deferred revenue, it doesn't fully come through in revenue yet. And then in cybersecurity, consulting, a decrease from €50 million level to €45.8 million. But in the circumstances, I think we can also say that we've had a recovery on our way to a better future. There will be uncertainty, however, in the market because of COVID-19. So we're not fully out of the woods there yet.

Then if we look at the revenues split in terms of growth by – and growth by geography, starting this time from the top, Nordics, which has typically been a strong market for us, we saw slight decrease from €72.5 million to €70.9 million in terms of annual revenue. But overall, then in Europe, the middle bar from €96.2 million to €98.9 million, slight growth. And then North America, substantial growth from €19.7 million to €23.2 million and other regions, €28.9 million to €27.1 million, slight decrease. So kind of a mixed bag as you would expect.

And then looking at the EBITDA in 2019, comparing the first three quarters of the year, we went from €16.6 million to €28.4 million. And then in terms of the last quarter, €6.6 million to €7.3 million. So a market improvement in EBITDA margin, taking us to the level of 16% with an improvement of €12.5 million that we can be satisfied about.

We did see strong orders, as mentioned, in corporate security products. They are visible in deferred revenue, not yet in reported revenue. Revenue from both Managed Detection and Response, what we call MDR and the endpoint security grew, and we saw customers committing to multiyear deals. Some of the very important deals, we managed to close in MDR, for example, are multiyear deals in nature. And that is, of course, important for us, because we want to continue building a strong recurring business.

In cybersecurity consulting, our revenue decreased by 8%, and as mentioned, positive development compared to previous quarters in the last quarter. Consumer security revenue grew by 11%, that we can be very satisfied about strong performance. Having said that, there were certain one-off items, but overall strong growth nevertheless.

Business activity levels overall in the market started to normalize, we saw that. And of course, we saw that in terms of our profitability as well ended up in the Q4 being at the level of 13%. We did have some items towards the end of the year, for example, related to consumer business related marketing campaigns and so forth, external spending that we had. The board of directors is proposing to the AGM a dividend of €0.04 per share.

Moving on from Q4 and now looking at the whole year, corporate products, how did revenue grow? So overall, you see here the development between the past three years, 2018, 2019, 2020. And as you can see, we have grown, as mentioned, between 2019 to 2020, year-on-year growth, 2%. And then comparing the quarters, you will see how we fared between €54.2 million, going up to €55.5 million and then in the last quarter, €18.3 million to €18.7 million.

So where did the sales come from? So we clearly saw new sales strongly, especially in the cloud-based products that are a growth area for us in the corporate security side. And we clearly saw our orders outpacing the revenue growth. We saw a rise in contract duration. That is an important metric for us. And that means, of course, that the revenue impact of the new orders is spread over a longer time period.

Good traction among the focused channel partners across our main markets in Europe and in Japan. In business security, we have been quite focused during the past year in building and improving our partner channel. So clearly, we have had a long, long list of channel partners. At the same time, we have been very focused in also developing the larger partners for our business. And that work is ongoing, and we are on the right track there.

Japan, an interesting market for us in many respects. There, clearly, we saw positive development. One of those projects was so-called GIGA School project, where the Japanese government has decided to give out – handout laptops to school children and those laptops, of course, need the protection and F-Secure has been selected as one of those providers there.

In our Managed Detection and Response, MDR for short, and in the F-Secure Countercept, which is the product there, we clearly saw an increase in revenue but more importantly, we saw that we were able to close several new deals with very demanding customer verticals. To mention a few, one of them was in technical trade and critical infrastructure and finance. We have been historically been strong, especially in the finance sector that – where we provide solutions to larger enterprises. And we did secure multi-year deals also in UK, Germany and South Africa, and our renewal performance was good.

And here, we are showing and opening up a little bit more the deferred revenue that we talk about. And of course, this is important in the context of understanding what is the relationship between the order intake and our ability to show that as a revenue. And here, you can see that how much, if we look at the total corporate security products, how much of the revenue is coming from a – or can be split between the noncurrent and current, i.e., the deferred and current revenue. And here, you see a sharp increase in the deferred revenue as shown in the graph on the right-hand side.

Maybe a few words about why F-Secure? So why do clients choose us? And this example is from Countercept, which is in the area of Managed Detection and Response. The customers that we typically encounter, they have recognized that they need to enhance their detection and response capabilities. At the same time, they are challenged by budget, time or just their ability to cope with those problems in-house. They may not have the staff, they may not have the competence. And oftentimes, they have been approaching this solution with a more generic managed services, security services provider or third-party security solution, combined with large internal security team.

What we bring to the table is extension of the client security team. Our people go in there with their expertise to support the customers, our proven ability to respond to attacks, superior to competition, complemented by our own technology stack. We are a technology company. We can also complement our services offering with technology.

On one hand, it's important in order to get the full benefit out of that development work. But at the same time, also, it makes us more efficient in the way we do the work. It takes us further in terms of having the ability to utilize AI machine learning and automation, and that development, of course, will continue.

Our experts step into high-fidelity data sources, and that gives them extensive threat coverage. So you could ask yourself, what is the difference between this approach and deploying a – just a security platform or a software platform from a third-party vendor. I think the difference here is that, we are outcome-based in terms of the way we work. So we go deep, and we are obligated to show the results that actually make an impact rather than just deploying a software and then concluding that this was it, and the software is running, and we hope it's doing its job. In our case, we prove to the customers that we are doing the job right.

In terms of our business security software products, clearly, outside of us, the world is going cloud. All of our customers, all the end customers are on a journey, which has either taken them to the cloud or is taking them to the cloud. And that, of course, is reflected in our offering as well. We have been typically very strong in classic endpoint protection. We have taken that solution to a cloud-native environment.

And then, of course, we have enhanced our offering to cater for the new opportunities there are in this cloud driven market. And one of those opportunities is related to, for example, our protection that we are able to offer to software partners, one of them being, for example, Salesforce. We offer cloud protection for Salesforce customers. And we distribute our product through their app exchange. And that particularly has been a very interesting and growing area for us.

Consulting, just to go a little bit deeper still into the history. So, what is our history first in terms of the evolution between 2018 to 2020? In 2018, our security consulting revenue was €32 million. We grew that to €50 million in 2019 and now we had a decrease of 8%, landing at €45.8 million for the whole year 2020.

At the same time, we had a very strong Q4, and that is, of course very good foundation to continue. There were substantial variations in terms of this revenue, so we saw a good performance in the largest markets, such as UK and Nordics and then there were some regions where it was more challenging for us during this time.

This is another example of how we are actually serving our customers. And in an example, there is a so-called APT, Advanced Persistent Threat. Now, this example takes you through a time cycle of 40 days, and it starts by customer discovering that there are cryptominers on the network causing a performance threat.

The customer takes us in, deploys our Countercept and we discover two of these APTs and multiple old infections. We provide the containment. We provide the customer with the advice how that is done. And the impact is that there is immediate containment work that has started.

At the same time, the actors, the criminals are not passive. So, they have come back with public ransomware notes. We investigate deeper and we go in with persistent methods and methodology and tools and we are able to detect and remove the ransom notes and find the remaining persistent methods. As an outcome, the threats are promptly removed to eradicate the threat actor from the networks. And this has taken us about 40 days.

And oftentimes, of course, when we look at the customers, they may be doing one part well. So, often, there is a question of having very good detection capabilities. But of course, as you would logically expect, it is also very important to have the right response. So, what do we do about it when we are there? We might have the perfect

discovery capabilities, but not the response capabilities. So, that's where we come in, and we can provide this holistic service for our customers where the outcome is very clear.

Back to consumer. So, 11% growth, and of course, as you can see from the chart here between 2018 to 2019, 2018 to 2019 saw a flattish growth, actually almost no growth at all, whereas now taking a major jump forward from 2019 to 2020.

And clearly, of course, as you would expect, this comes from increased sales of our core EPP, Endpoint Protection solutions. And in this business, we have also seen that the remote working, the COVID-19 impact, the leap in digitalization, they have, of course, accelerated this growth. And it has been an opportunity that we have capitalized on. At the same time, we have also launched new products such as ID PROTECTION. And there, we have signed with new operator partners in Asia and Europe.

As you may remember, we are selling also directly to consumers. So we saw also positive performance with the F-Secure TOTAL offering. And the important metric, renewal performance continued to be on good level. So concluding, both e-commerce, retail channel operators grew this time.

Going forward and looking at the potential of consumer security, we see that we are set for growth also in the future. We have launched new products there. We have signed new deals and we expect that to continue in a positive track going forward.

That concludes my part of the presentation. And now I would like to hand over to our CFO, Eriikka Söderström. Thank you.

Eriikka Söderström

Chief Financial Officer, F-Secure Oyj

Thanks, Juhani. So I'll cover a bit more in detail the numbers, and then you have an opportunity to ask questions from us. So growth and normalizing activity levels resulted in adjusted EBITDA of 13% as a highlight for this Q4 reporting. I like when we say that the year ended in a positive tone. And this is true if we look at this exceptional year.

Q4 revenue landed in €57.9 million, is a 3% growth, but when you look at these different businesses of ours, consumer security, 11% growth. It did have this one-off impact of a couple of percentages, but still very strong growth. And then, corporate security products with a 2% growth and cybersecurity consulting with a minus 8% growth.

There, I would want to highlight that this one large project in Nordics that we have been referring to is in the finalization phase and the year-on-year comparison numbers are taking the consulting where this project is included down. So the normal consulting without this one exceptional project, the situation is still challenging, but better than the number that you see there, clearly. So positive tone, also, what we see happening in the consulting business towards the end of the year.

And then the adjusted EBITDA, €7.3 million, 13%; EBIT, 3.1%, 5% of revenue. And very happy to report the strong cash flow of €19.4 million in Q4. I will explain a bit more where that comes from later on with the slides. So the EPS achieved in the fourth quarter, €0.02.

And then if we look at the whole year, the story doesn't change. So revenue, 1% growth, we reached €220.2 million, a small increase from last year. But then consumer security, about 6% growth, while the corporate security products, 2% growth and the consulting, negative 8%.

But the adjusted EBITDA for the full year, the 16% of revenue, €35.7 million, that was clearly better than what we anticipated when this COVID-19 started. And I guess that, this is the same with many other companies as well, that the cost levels have been lower due to the lower activities possible. However, in Q4, we see really increased activity base already.

EBIT for the full year, €19.7 million and 9% of revenues and in fact, it's net cash, €11.6 million, and the full year cash flow from operations before financial items and taxes are €48.3 million. That is exceptionally strong number. And the EPS, €0.08, while last year, it was €0.02 and a slight decline in the personnel amount.

So, Juhani did already share with you this picture about the deferred revenue, but maybe I still talk about it a bit because this is now the one where we wanted to show you that there was a significant change now, if we look at the trend on the left-hand side. So €81 million of deferred revenue compared to a year ago, €73.9 million, 10% growth. And on the right-hand side, you can see this growth in lines and the current being below 12 months and non-current deferred revenue, which goes beyond a year.

So what this tells is that we have had multiyear deals in corporate security and so the revenue will be extending for a longer period of time. But this is just good news. So we have in the back pocket now deferred revenue. But it also tells about that we have seen good order intake in Q4.

Then talking about the profitability, so adjusted EBITDA this year, nothing major between adjusted and the reported EBITDA but this curve to have apples-to-apples, shows the adjusted EBITDA development. And you see that the Q4, 13% is now in the same level as we were in Q1. So what happened in the Q4, especially? So we have been hiring people, increasing the R&D spend, but also the marketing expense has been higher than what we saw in the middle of the year. So a lot of digital marketing events took place before the year-end and that kind of things. So that is impacting the 13% that we see there.

And then looking at this cash flow part, so as you can see, now on a quarterly basis, on the left-hand side that Q4 really was exceptionally strong quarter. Cash flow from operating activities before financial items and taxes, it improved €10.7 million. And it is a combination of a few things, out of which, the strong order intake with license type sales where the customer pays us upfront. So we get money for the full duration of the contract.

Even if we see the SaaS increasing, but we still have significant share in this traditional license sales. Then in addition, of course, the profitability impacts positively the cash flow but then one area, which I'm actually quite proud of is the fact that we have been able to collect a lot of overdue receivables during the year. We have improved the process. We took action in the spring when COVID-19 hit and nobody knew how the world looks like. And so, that has resulted as a positive improvement now, which is visible in the cash flow. And that means that from the cash and financial assets perspective, so our situation at the end of the year was that we have €51.4 million cash and financial assets and as I already mentioned, so the net cash position is almost €12 million.

And then having the strong profitability and also looking at the balance sheet and then how we see the future, so our board of directors is proposing a dividend of €0.04 per share. And as you can see in this slide in year 2019 and 2020, we did not have any dividend payouts, but now the proposal, €0.04.

And then finally, related to the 2021, so the outlook. So for the corporate security products, the revenue is expected to grow at a high single-digit rate. And the cybersecurity consulting revenue is expected to grow, but uncertainty remains due to the COVID-19 pandemic. We wanted to highlight that one because consulting is the one where you can see an impact if things get more to the bad direction again, no one knows. But there as well, we expect to grow. And the consumer security revenue expected to grow approximately at the same rate as in 2020.

And then adjusted EBITDA, which was €35.7 million in 2020. So 2021 outlook that adjusted EBITDA expected to remain approximately at the previous year's level. So this is the outlook. So we expect all our businesses to grow. And we say that in the adjusted EBITDA, there were like savings, especially related to COVID-19 and this approximately in the same level as 2020 is now the outlook that we give.

I guess that was my last one, and it's time for questions. So Henri, have you gotten any questions?

QUESTION AND ANSWER SECTION

Henri Kiili

Investor Relations & Treasury Director, F-Secure Oyj

A

Yes, we do. We have a couple of good ones here. So first one goes to Juhani. You have been leading the company roughly 100 days. What is your first take on F-Secure's current positioning in the markets? And should we expect changes in strategy?

Juhani Hintikka

President and Chief Executive Officer, F-Secure Oyj

A

So first of all, it's been a good 100 days in a sense that despite the pandemic, I've been able to meet quite a lot of people and customers remotely. And I think I've been very pleased to find that we have truly deep technical expertise among our personnel and very strong customer relationships. And of course, that is – it's a great foundation for any company to build its way forward.

As to any changes in strategy, I think it's far too early for me to make any major announcements around that. But as any new CEO, of course, I continue to review our strategy and operations and plan with the team the way forward.

Henri Kiili

Investor Relations & Treasury Director, F-Secure Oyj

A

Okay. Thank you. Continuing from there, how are you planning to accelerate growth in MDR and EDR, and in the medium term, especially?

Juhani Hintikka

President and Chief Executive Officer, F-Secure Oyj

A

Yes. MDR, EDR. I think regarding MDR, clearly, the market is a growth market, and we have a good position in that. We will continue to focus our efforts in the customer interface, being a very good partner for our customers. And we will also strengthen our messaging towards the market in terms of why F-Secure and why are we interesting. To that effect, we have also appointed a new chief marketing officer in the company who has started just a few weeks ago.

And regarding EDR specifically, I think a good portion of our EDR growth also will come in conjunction with our EPP business where we typically have a very strong business, and those customers and partners are also looking to complement that offering with EDR.

Henri Kiili

Investor Relations & Treasury Director, F-Secure Oyj

A

All right. Then next one, I think this one goes to Eriikka. So you're already in net cash. Could you elaborate a bit more of your plans for the cash pile?

Eriikka Söderström

Chief Financial Officer, F-Secure Oyj

A

That's a good question. And I would say that at this stage, standing next to the new CEO, who says that let me look at the strategy, so that is the reason why it is like what it is at this point. And I think that I'll wait and see that how can we support the company plans going forward, and then we look at the balance sheet accordingly.

Henri Kiili

Investor Relations & Treasury Director, F-Secure Oyj

A

All right. We have another question related. Are you looking for new acquisitions and which kind of operation/technology would create the best fit for you?

Juhani Hintikka

President and Chief Executive Officer, F-Secure Oyj

A

M&A is part of the toolkit we have at our disposal, of course, and as normal part of our business, we are in continuous dialogue with the market and potential targets there. So I think, consider it business as usual also for us.

Henri Kiili

Investor Relations & Treasury Director, F-Secure Oyj

A

Yes. Then let's take a slight reminder. So what was the positive impact of non-recurring items in consumer security? So for the whole year and then for Q4, specifically?

Eriikka Söderström

Chief Financial Officer, F-Secure Oyj

A

For the whole year, the consumer, like if we exclude the one-offs, so instead of 6%, it will be approximately 5%, like 1%. And then in Q4, it would be a couple of percentages.

Henri Kiili

Investor Relations & Treasury Director, F-Secure Oyj

A

Yes. What are the main growth drivers in corporate security products in 2021?

Juhani Hintikka

President and Chief Executive Officer, F-Secure Oyj

A

We will continue our efforts in strengthening our partner channel. We have been also making investments in what we call the F-Secure Elements, which is a product suite, especially serving the business security, customer base and we expect fully to see the positive impact continue from this and show in results in 2021.

Henri Kiili

Investor Relations & Treasury Director, F-Secure Oyj

A

Yeah. Still for the new CEO. So what do you think are the main improvement areas for F-Secure broadly?

Juhani Hintikka

President and Chief Executive Officer, F-Secure Oyj

A

Well, I think in many ways, as I said, we have a strong position. But at the same time, there's always room for improvement. And clearly, what I mean by that is that there's room to grow and clearly, we can further sharpen our message, and we can further sharpen our approach in go-to-market and win more business and more customers while taking care of the technology base and products that we have built.

There are certain things that have already been started, for example, building a common technology base with the [ph] XDR (35:47) platform, as we call it, and we will be rolling that out during 2021, and that will be an important catalyst for longer-term scaling and growth.

Henri Kiili

Investor Relations & Treasury Director, F-Secure Oyj

A

Yes. Then what about the competitive landscape? And specifically, what kind of a threat Microsoft is in consumer security and what about in corporate security?

Juhani Hintikka

President and Chief Executive Officer, F-Secure Oyj

A

Well, as an overall market, of course, this is a very hot market for many reasons. We've talked about the near past with COVID-19, the digitalization leap, all of those things, of course, accentuate the need for good protection and cybersecurity. At the same time, I think we need to choose also the segments where we want to excel and focus on our performance in there.

Henri Kiili

Investor Relations & Treasury Director, F-Secure Oyj

A

Yes. And then let's go back to the deferred revenue and orders that we were referring to. So you're saying that the order intake was good. So what type of growth approximately would this mean? Would it be from 0% to 5% or more than 15%?

Eriikka Söderström

Chief Financial Officer, F-Secure Oyj

A

The last one.

Henri Kiili

Investor Relations & Treasury Director, F-Secure Oyj

A

Then going to consulting, do you see pent-up demand in the markets due to the COVID-19 restrictions?

Juhani Hintikka

President and Chief Executive Officer, F-Secure Oyj

A

So I think it's a polarized market, as I think I said earlier. So yes, there is pent-up demand in terms of the increased need for cybersecurity protection and response capabilities. At the same time, there is also a group of

customers that haven't been doing so well during the pandemic in terms of their business. And that will, of course, limit their ability to invest also in cybersecurity.

Henri Kiili

Investor Relations & Treasury Director, F-Secure Oyj

A

All right. Then taking a look at our capacity. So, do you have sufficient capacity to respond should the demand return rapidly?

Juhani Hintikka

President and Chief Executive Officer, F-Secure Oyj

A

So, of course, as you are aware, we are running both services-driven approach to the market in terms of consulting and to a degree, also Managed Detection and Response and then we have a software business. With software business, the scaling and the capacity in a way, is related to our go-to-market, which in this case is mostly about our partner network and we will need to continue to develop that. We already have a very strong partner network. We believe that we will be able to grow a lot only with scaling the business with that.

And then on the services side, of course, at some point of time, you will need to increase your head count that will bring in revenue. We are continuously though trying to do things in a better way, we're trying to learn from those cases, we're trying to automate and use advanced tools, such as tapping into data using AI and machine learning to become more and more efficient and effective on that so that we wouldn't purely rely on head count driven growth in services.

Henri Kiili

Investor Relations & Treasury Director, F-Secure Oyj

A

Yes. Then this one is for Eriikka, I guess. So will the positive one-offs in consumer security continue in H1 2021?

Eriikka Söderström

Chief Financial Officer, F-Secure Oyj

A

Shouldn't be material. I expect not to see them.

Henri Kiili

Investor Relations & Treasury Director, F-Secure Oyj

A

So can we conclude that the impact was mainly in H2 2020?

Eriikka Söderström

Chief Financial Officer, F-Secure Oyj

A

Correct.

Henri Kiili

Investor Relations & Treasury Director, F-Secure Oyj

A

Yes. So that's all of the questions that we had.

Eriikka Söderström

Chief Financial Officer, F-Secure Oyj

A

All right.

Henri Kiili

Investor Relations & Treasury Director, F-Secure Oyj

Thanks a lot for presenting.

Juhani Hintikka

President and Chief Executive Officer, F-Secure Oyj

Okay. Thank you very much.

Eriikka Söderström

Chief Financial Officer, F-Secure Oyj

Thank you.

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