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Varonis Systems, Inc. (VRNS)

Q1 2025 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings, and welcome to the Varonis Systems, Inc. First Quarter 2025 Earnings Conference Call. At this time all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Tim Perz. Thank you. You may begin.

Tim Perz

Vice President-Investor Relations, Varonis Systems, Inc.

Thank you, operator. Good afternoon. Thank you for joining us today to review Varonis first quarter financial results. With me on the call today are Yaki Faitelson, Chief Executive Officer; and Guy Melamed, Chief Financial Officer and Chief Operating Officer of Varonis. After preliminary remarks, we will open the call to a question-and-answer session. During this call, we may make statements related to our business that would be considered forward-looking statements under Federal Securities Laws, including projections of future operating results for our second quarter and full year ending December 31, 2025.

Due to a number of factors, actual results may differ materially from those set forth in such statements. These factors are set forth in the earnings press release that we issued today under the section captioned Forward-Looking Statements, and these and other important risk factors are described more fully in our reports filed with the Securities and Exchange Commission. We encourage all investors to read our SEC filings. These statements reflect our views only as of today and should not be relied upon as representing our views as of any subsequent date.

Varonis expressly disclaims any application or undertaking to release publicly any updates or revisions to any forward-looking statements made herein. Additionally, non-GAAP financial measures will be discussed on this conference call. A reconciliation for the most directly comparable GAAP financial measures is also available in our first quarter 2025 earnings press release and our investor presentation, which can be found at varonis.com in the Investor Relations section. Lastly, please note that a webcast of today's call is available on our website in the Investor Relations section.

With that, I'd like to turn the call over to our Chief Executive Officer, Yaki Faitelson. Yaki?

Yaki Faitelson

Chief Executive Officer, President, Co-Founder & Chairman, Varonis Systems, Inc.

Thanks, Tim, and good afternoon, everyone. Thank you for joining us today to review our first quarter results, the progress of our SaaS transition and to remind you why Varonis is best positioned to secure the world's data. In the face of uncertainty in the world today, there is one constant which pushes the business case for Varonis no matter what will happen, people will eat, sleep and create data. The world is completely dependent on data, and because of its importance thereafter who want to steal it. At the same time companies struggle to protect it. Most organizations deploy technologies to protect their endpoints and the perimeter. These technologies are very important, but they aren't enough to protect data.

Varonis takes a data-first approach and helps companies to locate their sensitive data, visualize with access to it, automatically lock down and then automatically detect and respond to threats on it. Last quarter we announced

that we will be accelerating our SaaS transition, and our Q1 results prove that we are well on track to complete it by the end of the year. The reason we are accelerating this transition is because of the strong demand for our SaaS solution and the benefits to our customers, our company. Simply put, Varonis SaaS is a much better way to deliver our platform and to protect our customers' data more effectively and efficiently.

With Varonis SaaS, customers are able to realize greater value from our platform without effort, which leads to more satisfaction, and we believe will better position our company to accelerate growth. In the first quarter, ARR grew 19% to \$664.3 million, and we continue to progress towards completing our SaaS transition. With SaaS, ARR are now representing approximately 61% of total ARR, or \$403.9 million. We generated \$65.3 million of free cash flow this quarter, up \$56.4 million in the same period last year. Guy will review our results and updated guidance in more detail shortly. Our first quarter results reflect strong contribution from both new and existing customers that are driving our overall business momentum.

Organizations face a dangerous threat environment and their security teams are [indiscernible] (00:05:09), which means they struggle to see and respond to threats as quickly as they must with today's bad actors. The automated value proposition of Varonis SaaS platform and MDDR offering resonates with security teams. With Varonis, these organizations can secure their data with very little effort, because we do the hard work for them. This is an outcome that simply cannot be achieved by using point solutions or manual role. We've also continued to see very healthy customer interest in safely deploying Copilot and other generative AI tools, which is serving as a reason for new customers to engage with Varonis and also for existing ones to convert to a SaaS platform.

We see massive opportunity to increase the ARR from our existing customer base, and in the first quarter we continue to see existing customers expand their deployment and increase their spend with us. Varonis SaaS is a no-brainer for customers because of the value that it offers. In the first quarter, we were able to convert existing customers to SaaS more effectively because of the lessons we learned last year and the additional investments that we made in our team. This is now also freeing up capacity of our sales teams that are bringing in healthy levels of new customers, while also upselling additional platforms to our broader customer base.

Existing SaaS customers continue to expand their journey with Varonis, while many of our customers choose to start with their Varonis deployments by protecting data in Microsoft 365 or on-prem storage platforms, because that was their top security concern. They realized that they had sensitive data in many places beyond the areas where they originally deployed us. This is why we have significantly expanded our coverage in recent years to include leading cloud data stores, which means we cover data everywhere. Our breadth and depth of coverage has become one of our biggest competitive advantages, which means that we are able to provide customers with automated data security wherever they have sensitive data.

DA Cloud is working well, and during Q1 we continued to see customers looking to Varonis to secure data across these newer cloud data stores, and we believe our ability to execute into this large and fast-growing market position us to continue to accelerate growth once we completed the SaaS transition. And our benefit of SaaS is that, it gives us the ability to innovate much faster. During Q1, we did exactly that, announcing Varonis for Agentforce, which allows organizations to safely enable agentic AI roll-out in Salesforce. We view agentic AI as a massive opportunity, because agents inherit the permission of the users who want them. So if users have excessive access, agents can expose sensitive data.

For example, if a bank uses Salesforce to process mortgages, guess what would happen when you upload your financial documents with your application. All that information ends up in Salesforce as records, files and attachments. Salesforce can classify individual fields, but there is no way to find classified or protected files and attachments natively in Salesforce. Varonis allows organizations to find sensitive data automatically. It's exposure

to very complicated permission model detects threats on the data and safely enable the data usage of agentic AI. To finish our example, Varonis automatically removes access to ensure real sensitive mortgage application is not unnecessarily exposed by an agent.

In March, we announced acquisition of Cyral, which expands our data security platform to include next generation database activity monitoring. Cyral's innovative approach to database activity monitoring deploys quickly and allows customers to upgrade the costly legacy solutions and unify the structured and unstructured data security monitoring, which means, Varonis can sell as a single pane of glass for securing any kind of data as a unified platform, will now be able to address more auditing and compliance use cases, in addition to being a strong strategic fit, this market is attractive to us, because it has established budgets and [indiscernible] (00:10:16) due to a lack of innovation for incumbents in recent years.

This acquisition speeds our time to market and expands our total available market drastically as we enhance our ability to help customers protect their data and allow them to consolidate their data security budgets in Varonis. With that, I would like to briefly discuss a couple of key customer wins in Q1. New logos continued to be key driver of our business, in this quarter a large healthcare system with over 100,000 employees became Varonis customer after suffering a ransomware attack that impacted millions of patients. They evaluated Varonis a number of point solution in the data classification and DSPM categories to lock down their sensitive data and ultimately purchased Varonis SaaS for Windows with MDDR protection and Varonis for Google Drive.

Varonis was the only platform that could automatically secure their sensitive data in Google and on-prem, while proactively monitoring it for threats. While new customers drove most of our momentum this quarter, we are also seeing strong demand from existing customers, looking to convert to a SaaS platform and expand their protection to cover new critical cloud data stores I mentioned a few moments ago. An example from this quarter was a multinational consumer product company with approximately 6,000 employees that first became a Varonis customer years ago. They initially utilized Varonis to map permissions and classify data on prem. This year they determined they needed the automation of Varonis SaaS and Nvidia, because they were severely understaffed and faced an executive mandate to safely deploy Copilot.

Over the time, they had been our customers, Varonis fixed over 10 million overexposures on-prem and tens of thousands of overexposed links in Microsoft 365, which convinced them that they would be able to safely deploy Copilot. This customer purchased Varonis SaaS for hybrid environment as well as Varonis for AWS, Azure, Google Cloud, Snowflake and GitHub, which will enable them to safely protect their data in the cloud and in SaaS applications. In summary, we are excited by the continuing momentum we are seeing across our customer base that is driving our growth. Our solution has never been more relevant, and we look forward to completing a fast transition this year, which will unlock many more benefits for our customers and our company as we execute on our significant market opportunity.

With that, let me turn the call over to Guy. Guy?

Guy Melamed

Chief Financial Officer & Chief Operating Officer, Varonis Systems, Inc.

Thanks, Yaki. Good afternoon, everyone. Thank you for joining us today. Our first quarter performance represents a solid start to the year highlighted by an acceleration in ARR growth, sustained improvement in free cash flow, and continued progress towards the completion of our SaaS transition. This performance allows us to raise our full year ARR guidance as we focus on executing on factors within our control, while closely monitoring the uncertain macroeconomic backdrop. We remain confident in our outlook, because of the underlying drivers of our business and are well-positioned to capitalize on our growing customer demand. Our Q1 results demonstrate

sustained new customer momentum, and that the investments we made in our team and lessons we learned regarding existing customer conversions is working.

As a result of this momentum, we ended Q1 with 61% of total company ARR coming from SaaS, an 8 points increase in the SaaS mix from the 53% we reported in Q4. When we look at the SaaS NRR, we continued to see very similar trends to last year, which was significantly above our total company NRR reported in 2024. This shows us that SaaS customers are coming back and buying more, which combined with the healthy new customer momentum that we are seeing gives us confidence that we can return to more than 20% ARR growth. In the first quarter ARR was \$664.3 million, increasing 19% year-over-year. And this quarter we generated \$65.3 million of free cash flow, up from \$56.4 million in the same period last year.

In the first quarter total revenues were \$136.4 million, up 20% year-over-year. During the quarter, as compared to the same quarter last year, we had approximately a 1% headwind to our year-over-year revenue growth rate as a result of having increased SaaS sales in our booking mix, which are recognized ratably, versus the upfront recognition of our on-prem subscription product. SaaS revenues were \$88.6 million. Term license subscription revenues were \$31.5 million. And maintenance and services revenues were \$16.4 million as our renewal rates were again over 90%. Maintenance and services revenues declined by 32% year-over-year with a vast majority of the decline driven by perpetual maintenance customers converting to our SaaS platform.

Moving down to the income statement, I'll be discussing non-GAAP results going forward. Gross profit for the first quarter was \$109.4 million, representing a gross margin of 80.2% compared to 83.3% in the first quarter of 2024. Operating expenses in the first quarter totaled \$115.9 million. As a result, first quarter operating loss was \$6.5 million, or an operating margin of negative 4.7%. This compares to the operating loss of \$10.6 million or an operating margin of negative 9.3% in the same period last year. During the quarter as compared to the same quarter last year, we had approximately a 1% headwind to our operating margin as a result of having increased SaaS sales in our booking mix, which are recognized fully ratably versus the upfront recognition of our on-prem subscription product.

First quarter ARR contribution margin was 16.7%, up from 13.7% last year. The significant leverage improvement reflects our ability to drive strong incremental margin, while growing ARR and transitioning to SaaS. During the quarter we had financial income of approximately \$10.7 million driven primarily by interest income on our cash, deposits and investments in marketable securities. Net income for the first quarter of 2025 was \$0.7 million or \$0.00 per diluted share compared to a net loss of \$3.7 million or net loss of \$0.03 per basic and diluted share for the first quarter of 2024. This is based on 136.7 million diluted shares outstanding, and 110 million basic and diluted shares outstanding for Q1, 2025 and Q1, 2024, respectively.

As of March 31, 2025, we had \$1.2 billion in cash, cash equivalents, short term deposits and marketable securities. For the three months ended March 31, 2025, we generated \$68 million of cash from operations compared to \$56.7 million generated in the same period last year. And CapEx was \$2.3 million compared to \$0.3 million in the same period last year. During the first quarter, we repurchased 1,476,456 shares at an average purchase price of \$41.49 for a total of \$61.3 million. Turning now to our updated 2025 guidance in more detail, our acquisition of Cyral is not expected to have any impact on ARR or revenue this year, and is expected to add approximately \$4 million of operating expenses in 2025.

For the second quarter of 2025, we expect total revenues of \$145 million to \$150 million, representing growth of 11% to 15%. Non-GAAP operating loss of negative \$5 million to negative \$2 million, and non-GAAP net income per diluted share in the range of \$0.00 to \$0.01. This assumes 135.2 million diluted shares outstanding. For the full year of 2025 we now expect ARR of \$742 million to \$750 million, representing growth of 16% to 17%, free

cash flow of \$120 million to \$125 million, total revenues of \$610 million to \$625 million, representing growth of 11% to 13%, non-GAAP operating income of \$0.5 million to \$10.5 million, non-GAAP net income per diluted share in the range of \$0.14 to \$0.17. This assumes 135.8 million diluted shares outstanding.

In summary, we are encouraged by our first quarter results, which were highlighted by broad-based strength and is leading to healthy ARR growth, operating leverage and cash flow generation. This performance gives us confidence to raise our full year ARR guidance as we progress towards the completion of our SaaS transition later this year.

With that, we would be happy to take questions. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] The first question we have is from Matt Hedberg of RBC. Please go ahead.

Matthew Hedberg

Analyst, RBC Capital Markets LLC

Q

Great. Thanks for taking my question, guys. Congrats on the results. It's really great to see the SaaS transition continue to accelerate and finished by year-end. One of the key questions that I get from a lot of investors is, what gives you guys confidence that ARR can grow sort of north of 20%, Guy, you illustrated. I think, Guy, you mentioned SaaS NRR is significantly above total NRR. But is there any other things that you would give us as guidepost around the confidence in that element?

Guy Melamed

Chief Financial Officer & Chief Operating Officer, Varonis Systems, Inc.

A

Matt, thanks for the question. When we look at our ability to grow 20-plus-percent, there are a lot of tailwinds that are working in our favor. One of the things that I mentioned in the prepared remarks is our SaaS NRR, and when you look at SaaS NRR, and to remind everyone, that doesn't include any impact from conversions, it was very healthy this quarter. So we continue to see very similar trends to what we saw last year with that SaaS NRR that is significantly above our total reported company NRR. So this really shows that the SaaS customers see value, and they want to protect additional platforms. So they are coming back and buying more, which combined with the healthy new customer momentum that we're seeing, gives us the confidence that we can return to that ARR growth of more than 20%.

Yaki Faitelson

Chief Executive Officer, President, Co-Founder & Chairman, Varonis Systems, Inc.

A

And Matt, it's Yaki. It's also very important to understand, this is the best way to avoid a data breach, bad actors are not [indiscernible] (00:23:47) they are logging in, no time to compromise identities, and then if you can protect your – if you can make sure that only the right identities can access the right data and stop any abnormal behavior, you will suffer a severe, most probably you will suffer a severe data breach, and data is going relentlessly on all platforms and is extremely valuable. And this is the most effective way to avoid a data breach. And with our SaaS platforms, customers are benefiting from it, and their information is protected in an automated way.

Operator: The next question we have is from Joel Fishbein of Truist Securities. Please go ahead.

Joel P. Fishbein

Analyst, Truist Securities, Inc.

Q

Hi. Thanks for taking the question and great results. Let me get some more color around MDDR adoption, and how the competitive environment around that and then how that could potentially be, to get to Matt's question, potentially be an accelerant to ARR?

Yaki Faitelson

Chief Executive Officer, President, Co-Founder & Chairman, Varonis Systems, Inc.

A

So in terms of the overall value, I see so many breaches with customers and usually they have one common ground, while this organization has a model security stack, a world-class EDR, a modern firewall, [indiscernible] (00:25:14) logs and it's severe breach. In order to make sure that you are protecting customers from a data breach, you need to have a very data-centric approach. If you want to protect data, protect data, make sure that you can remediate what you call the [indiscernible] (00:25:26), the excessive access control, automatically understand abnormal behavior. And also, once there is a compromised identity or an insider there is no perimeter anymore. So we are analyzing extremely well the user behavior of identities and user to make sure we understand any abnormal behavior and solving it automatically.

I really believe that if somebody wants to make sure that they don't have a data breach, they need something like Varonis. And the other thing to understand is also in terms of forensics. If something happened, you want to understand what happened to your data records, the fact that you can understand who is patient zero, what happened to endpoint and to reconfigure your active directory or end user repository and you don't know what happened to the data records, the liability can be endless. So even the ability to do a [indiscernible] (00:26:25) forensics need to be completely data-centric. And this is what you see from the MDDR, and we are doing it automatically for our customers and we build a lot of AI, we build a lot of security agents that augmenting our analyst, and this is working extremely well every day. We are saving several enterprises from severe breaches.

Guy Melamed

Chief Financial Officer & Chief Operating Officer, Varonis Systems, Inc.

A

From a numbers perspective, just to add to that, I think sometimes investors forget that MDDR was only introduced five quarters ago, and it has been by far the fastest adopted platform sale we have ever had. So we're very, very happy with how customers are adopting it. It's a no brainer, really, as Yaki mentioned. But when we look at the number and the adoption, we truly believe that, at the end of this journey, every single customer should have MDDR to be better protected. It's obviously going to take some time. But when you look at this adoption of this platform, it's been really outstanding. We're very happy with the way it's performed so far.

Operator: The next question we have is from Saket Kalia of Barclays. Please go ahead.

Saket Kalia

Analyst, Barclays Capital, Inc.

Q

Okay. Great. Hey, guys. Thanks for taking my question here. Guy, you said from the beginning that the NorthStars on this transition are going to be ARR, SaaS mix and free cash flow. But I wanted to ask about the income statement just for a second. And maybe the question is, how far are we from the trough in operating margins as we think about this transition accelerating? And are there any other dynamics that you want us to think about as we kind of think about sort of the model going forward with respect to that?

Guy Melamed

Chief Financial Officer & Chief Operating Officer, Varonis Systems, Inc.

A

So as you mentioned, the NorthStars are the ARR, free cash flow and the ARR contribution margins. And when you look at those kind of numbers, all of them have been performed extremely well throughout the transition. And if you look at the results in Q1, they're all pointing in one direction, is that we're moving nicely, quickly and keeping kind of the cost structure in a very prudent way. So I do want to emphasize that before I talk about the P&L. But from a P&L perspective, there is a lot of things that are going into the mix during a transition.

It's the conversions and the revenues recognized differently. So it becomes extremely messy. But I do think that the trough will happen this year, and then obviously next year you still have some bumpiness, because on the comparable side you'll get some volatility, but less. But I definitely believe that as we progress to complete the transition this year, the income statement starts to look more "normalized." But again, keep everyone's focus on during the transition to look at the three NorthStars. They are the leading indicators, ARR, free cash flow and ARR contribution margin.

Operator: The next question we have is from Joshua Tilton of Wolfe Research. Please go ahead.

Joshua Tilton

Analyst, Wolfe Research LLC

Q

Hey, guys, can you hear me?

Guy Melamed

Chief Financial Officer & Chief Operating Officer, Varonis Systems, Inc.

A

We can.

Joshua Tilton

Analyst, Wolfe Research LLC

Q

Awesome. Congrats on a great start to the year. I just wanted to double down, Guy, on one thing you said. I know you mentioned that you're monitoring the macro pretty closely. Could you maybe just double click on, what if at all, impacts in the quarter you saw because of the current macro, and maybe how you're thinking about or how you incorporate macro expectations into the guide for this year? Thank you.

Guy Melamed

Chief Financial Officer & Chief Operating Officer, Varonis Systems, Inc.

A

I think that's a great question. When we look at the macro, obviously there's a lot of macro uncertainty, but we had a really good quarter, and kind of the drivers that we talked about last quarter are really all in place, whether it's the SaaS transition, MDDR or GenAI. When you think about kind of the guidance and how we think about it, our philosophy hasn't changed. We treat the numbers we give Wall Street very seriously, and we feel very good about the pipeline in front of us. So when you think about that macro uncertainty, and despite it, really, we have never been so confident about the long term opportunity as we see it today.

So we try to remain focused on factors within our control, and we're confident in our ability to capitalize on a growing customer demand. So another thing that makes us feel really good is that, in the first quarter we saw strong demand from both new and existing customers, which led to that ARR acceleration we talked about, that continued leverage in our model and the strong cash flow generation. So when you combine all of these and these results and kind of the underlying drivers in our business is what gives us the confidence to raise our ARR

guidance by that \$5 million, and increase our SaaS mix to 80% for the full year, kind of despite that uncertainty that we see in the macro environment.

Operator: The next question we have is from Roger Boyd of UBS. Please go ahead.

Roger Boyd

Analyst, UBS Securities LLC

Q

Great. Thanks for taking the questions and I'll echo the comments, congrats on a strong quarter. Guy, you mentioned good traction with new logos in the quarter. I wonder if you could talk about, one, are we getting to the point where we can kind of quantify how often new logos are landing with some of the newer offerings, Varonis for some of the SaaS applications, cloud storages and databases? And then similarly on the strength in use cases around security and Copilot and other AI tools, are we getting to a point there where we can kind of quantify how big that traction is? Thanks. Thanks a lot.

Yaki Faitelson

Chief Executive Officer, President, Co-Founder & Chairman, Varonis Systems, Inc.

A

Hi. It's Yaki. I think that just to quantify it, just mathematically it's still half. But I will tell you, in every data repository, people have critical data, they have critical data in SaaS applications like Salesforce and ServiceNow, in cloud repository like databases, in Snowflake and in Databricks and they need to protect all of it. You still have a lot of data on-prem and in 365. And what happens with all the AI tools that we put a spotlight on the data security problems. So these agents, these Copilots, what they do, essentially, they are just using all the potential access and give you a lot of information and create a lot of information at a staggering rate. So if there is excessive access control, immediately employees will get information that they shouldn't get.

You can poison these AI models and you can also tag them. So as you're seeing more adoption of the AI tools, you will understand that in order to enable them you need data security and automated data security in order to make sure you can manage the tension between productivity and security. And this is something that we are doing very well. We believe that with us people will just eventually protect every data repository that they have. And this is why we see a lot of success with DA Cloud, and it's just working really well for us. We are very happy with all the investments we have done in the last few years, in data repository, user repository, protecting with AI tools, automated classification, they all come to fruition.

Operator: The next question we have is from Keith Weiss of Morgan Stanley. Please go ahead.

Keith Weiss

Analyst, Morgan Stanley & Co. LLC

Q

Excellent. Thank you guys for taking the question, and congratulations on a solid quarter. I want to ask a little bit about the recent acquisition that you made in the database activity monitoring space. It seems like a pretty logical extension, even a broader purview of the data within an enterprise as a state. Can you talk to us about sort of where that fits in, how you plan to just kind of add it to portfolio? And then a follow-on question to that, I think probably everyone on the line just came back from RSA last week. A lot of talk about data and data security. It feels like the environment is getting perhaps more competitive. Can you talk to us about how you're seeing the competitive environment evolving as this issue really comes to the forefront of the minds of CSOs?

Yaki Faitelson

Chief Executive Officer, President, Co-Founder & Chairman, Varonis Systems, Inc.

A

Yes. Hi, Keith. Thanks for the question. So first, in terms of databases, it's just a natural extension for us, and we started to see a lot of success with DA Cloud, classifying these database repositories, understanding a configuration and a admin usage. And just customers came in and told us, just not happy with the incumbents. And if you look at – if they had compliance requirements, we can answer everything, and if God forbid, they have an attack, it's always going from one data repository to the other. And they said, if you can go deep into the queries, it will be great, and logically they want to replace the current solution that they are using and using one scalable data security platforms that give them all these automated outcomes of threat detection and classification and remediation. In terms of the competitive environment, at this point, it's just doing very good for us.

So nothing changed for us in the competitive environment in terms of stuff like Office365 and all the Microsoft collaboration tools on the on-prem storages, and file systems on [indiscernible] (00:36:48) any file system or a NAS device, and all the DSPM space, primarily, these are not data security tools, it's primarily data discovery tools that many times still having hard time to scale and don't give you automation. They don't have remediation, they don't have any level of threat detection. They are not integrated with the identity layer. And what it does for us, it's actually at this point increasing our overall total available market and everything that we are doing in [indiscernible] (00:37:21) cloud data repository generate more awareness. And when customers are testing them, they understand that these are not security tools, you can't do forensics with them, you can't do remediation with them, don't understand if you had an attack. And I think that the fact that this is becoming, there is more [indiscernible] (00:37:42) it's really contributing for the success of DA Cloud.

Operator: The next question we have is from Joseph Gallo of Jefferies. Please go ahead.

Joseph Gallo

Analyst, Jefferies LLC

Q

Hey, guys. Thanks for the question and nice quarter. Last quarter you mentioned elongation of conversion cycle times. Has that length of cycle time for conversions changed in any way? And then how is the gross retention rates and ASP upside recognized in for those customers? Thanks.

Guy Melamed

Chief Financial Officer & Chief Operating Officer, Varonis Systems, Inc.

A

I think there were a lot of lessons that we have learned from the conversion process last year, and we have tried to implement them starting this year. I think we've done a very good job, and when you look at kind of the conversions that we had in Q1, they were really strong. And I think all of the investments and the lessons learned were implemented in a way that we're happy kind of to start the year with. When you look at the gross retention rate, when you look at the renewal rate, they're all very strong.

We definitely feel good about where we are, and we're seeing and we talked a lot about the fact that SaaS is purely a better product, and therefore we're seeing our existing customers try it and then want to buy more and be better protected. But really, it's important to note that the conversions weren't the only strong element this quarter, and we're definitely seeing strong new customer adoption. Again, it kind of relates to that SaaS platform that is being – the offering is so much better. So when you look at kind of the growth rate and our ability to get to that acceleration, it's coming from our existing customers buying more and our new customers that were really strong this quarter.

Operator: The next question we have is from Brian Essex of JPMorgan. Please go ahead.

Brian Essex*Analyst, JPMorgan Securities LLC*

Q

Great. Thank you. Good afternoon and thank you for taking the question. Yaki, I got a question for you. Great to see the innovation outside of Microsoft Copilot and to other gen-tech applications like CRM. Could you maybe provide a little bit of color in terms of your expectations for any different go-to-market motion? I think one of the concerns that investors may have had is that, in Office365 environment, you're competing against purview. Are you seeing a pull-in from Salesforce and other ISPs you might be working with, and do you anticipate maybe less friction with that go-to-market motion?

Yaki Faitelson*Chief Executive Officer, President, Co-Founder & Chairman, Varonis Systems, Inc.*

A

I just think that, as you will see more agentic AI and overall AI, what it does is just, it just put the data security problem in your face, if you will. You're using these agents and immediately you get information that you shouldn't get. It's very problematic. It will be very helpful organizations to function like that. So if you want to enable your organization to safely use AI, you need something like Varonis. You need to understand the activity, you need to right size the permissions, you need to do everything automatically. You need to look at the prompts and make sure that people are asking legitimate questions, because if not, it's an accident waiting to happen.

Operator: The next question we have is from Rob Owens of Piper Sandler. Please go ahead.

Ethan Weeks*Analyst, Piper Sandler & Co.*

Q

[indiscernible] (00:41:27). Thanks for taking my question. This is Ethan on for Rob this afternoon. As you guys think about consolidating more of the data security budget, what are some other natural adjacencies in the space that you think the platform would be well-suited to address going forward? Thanks.

Yaki Faitelson*Chief Executive Officer, President, Co-Founder & Chairman, Varonis Systems, Inc.*

A

I think that, obviously, database activity monitoring is a big one, a lot of stuff that related to understanding identity behavior, things that are relevant to the MDR environments, there is just a lot, and we also are building a lot of additional capabilities that can take additional budgets. But definitely, another source of budget is the AI budgets. These organizations are trying to adopt AI and want to do it in a secure way, you starting to have this allocated budgets for AI security, and enabling the organization to use AI and we are benefiting from it.

Operator: The next question we have is from Shaul Eyal of TD Cowen. Please go ahead.

Shaul Eyal*Analyst, TD Cowen*

Q

Thank you. Good afternoon, and congrats on solid set of results and guidance. Yaki, I wanted to ask very two little quick questions. One, what's the head count that you're adding with this small, with this tuck-in acquisition? And on macro, Guy or Yaki, DOGE specifically, I'm not talking about tariffs, et cetera, but DOGE specifically, have you seen anything emerging this quarter? Thank you.

Guy Melamed*Chief Financial Officer & Chief Operating Officer, Varonis Systems, Inc.*

A

I'll start with the second question, and thanks for them, Shaul. When we look at federal, and I want to remind everyone, the federal business for us is still relatively small, about 5% of total company ARR. And when we look at kind of the, when we look at the contribution in Q1, Q1 is not considered a large quarter for them. Their largest quarter is Q3. So when you think about kind of how we look at federal, we didn't see anything kind of evolve from DOGE. And the way we think about it from a guidance perspective is that, we didn't assume any significant contribution in comparison to last year.

So we are very happy with kind of the progress of the Fed ramp certification. It really is progressing as planned, and we hope to get it in the next few months. So we definitely believe in that long term opportunity and in that vertical. So that kind of relates to the federal question. In terms of Cyral, they don't have a significant number of head count. So it's a small number that doesn't impact us much. But when we think about that expense addition throughout the year, it's approximately \$4 million of additional expense throughout the year. If you look at kind of the guidance, you can see that it hasn't changed much. So we're able to absorb it from a guidance perspective, and we're not expecting any ARR or revenue contribution from the Cyral acquisition this year.

Operator: Next question we have is from Fatima Boolani of Citi. Please go ahead.

Mark Zhang

Analyst, Citigroup Global Markets, Inc.

Q

Hey, good afternoon, guys. This is Mark on for Fatima. Thanks for taking our question. Maybe just want to dig a little bit more into the new logo momentum you're seeing. It really comes this way, adjusting the sales org focus this year on really renewal conversions. So can you maybe give us a little bit of drivers there, how much did this outperform expectations? And maybe can you speak to any discernible changes, the new customer adoption behavior aside from maybe the AI-driven purchases, and any guardrails on how we should think of the contributions between new versus conversions to ARR guide this year? Thanks.

Guy Melamed

Chief Financial Officer & Chief Operating Officer, Varonis Systems, Inc.

A

We talked a lot about the fact that with the MDDR offering and kind of the fact that we have our Copilot addressing any, really any generative AI, it really is a no-brainer for new customers to adopt the platform. And we've absolutely seen a change in the way we can address those customers. We truly believe that our TAM has increased with the new offering, the simplicity of the offering, the fact that there's so much automation in the MDDR has really allowed us, together really with the Copilot being such an issue for our customers that want to adopt it, really helped us address the simplicity of going to new customers that we weren't able to sell to before and make that value proposition to be very much adopted in a healthy way. So we started seeing that last year. We saw this continue this year.

You heard us talk in the last earning call about the fact that we want to move as quickly as we can throughout the transition and complete it in 2025. I think, the results in Q1 are a very good start and showing that we're moving in that direction. So we try to balance and make sure that we're not only completing the transition, but the eye on the ball is still on getting new customers. Our salesforce has done a really good job of balancing those two, and I think that's kind of the reason we were able to show that acceleration, that beat on the raise on the ARR guidance, and the leverage in the model and the ARR contribution margin. So I think, those two elements of addressing new customers and being able to convert our customers in a more efficient way are what's helping us move forward the way we have so far.

Operator: The next question we have is from Jason Ader of William Blair. Please go ahead.

Jason Ader*Analyst, William Blair & Co. LLC*

Q

Yeah. Thank you. Good afternoon, guys. I wanted to ask on the gross margin outlook. I know that the SaaS transition is impacting that. Can you just talk about what you expect for the remainder of 2025, and then kind of more medium term outlook? And then just sort of related to that, why is the non-GAAP operating income range so wide? Can you just speak to that?

Guy Melamed*Chief Financial Officer & Chief Operating Officer, Varonis Systems, Inc.*

A

We're going back to revenue. Listen, revenue, the P&L in general throughout 2025 is going to get messy. You have to keep in mind that the way revenue is recognized through SaaS and on-prem subscription is so significantly different that it's generating a lot of volatility and it's a lagging indicator and doesn't indicate the health of the business at all. So you get the conversions and that generates a lot of messiness. So gross margin really, when you think about 2025, is not going to be reflective of anything. When we did our Investor Day in 2023, we gave out like a five-year model, and we put in our gross margin expectation, which was, at the end of 2027 to be in that range of the 80%, I can tell you that overall, as a concept, and I'm not talking about 2025 and we gave guidance from a revenue perspective.

But when we look at the performance of our cost on SaaS, it's exceeding our expectations significantly. So as a general concept and just to keep in mind, we are doing better than what we thought when we initiated the transition, but you're going to see that volatility until we complete the transition. And the reason that the range is so wide is because, there's so many factors that are embedded in this transition. Listen, it's not an easy task to take a ship and completely transition it from on-prem subscription to SaaS. I think we've done a great job so far, and we want to make sure that we complete the transition at the end of this year. So getting to 61% in Q1 was a great start. But again, there's a lot of volatility trying to bake in and consider what are the conversions and how it's going to impact, and that's why we took an extra range which I think is prudent.

Operator: The next question we have is from Rudy Kessinger of D. A. Davidson. Please go ahead.

Rudy Kessinger*Analyst, D. A. Davidson & Co.*

Q

Hey, great. Thanks for taking my question. Firstly, Guy, I want to make sure I heard you right. I think in response to Josh's question earlier, you said 80% SaaS mix by year-end on ARR. I think that's versus 78% expected previously. I want to make sure I got that right. And then secondly, I guess my real question, does it feel like we're getting any closer to an inflection point on the Copilot and GenAI stuff? Just what are you seeing from customer behavior, how is maybe the macro impacting the rollout of Agentforce, Copilot, et cetera? Thank you.

Yaki Faitelson*Chief Executive Officer, President, Co-Founder & Chairman, Varonis Systems, Inc.*

A

I think that the overall organizations understand that these AI tools are massive productivity gains, and definitely I think they still need to have their heads up, how they are going to use, exactly how to roll it out to all of their employees. But definitely, we see it as a driver, and we believe as it's going to be more and more on the hands of just knowledge [indiscernible] (00:51:35) you will see just more need and just demand for data, data security. So this is definitely something that we see across the board.

Guy Melamed

Chief Financial Officer & Chief Operating Officer, Varonis Systems, Inc.

A

And I did want to confirm, yes, you're right, we raised our guidance on the SaaS mix from 78% to 80% at the end of the year.

Operator: The next question we have is from Shrenik Kothari of Robert W. Baird. Please go ahead.

Shrenik Kothari

Analyst, Robert W. Baird & Co., Inc.

Q

Hey. Congrats team. Thanks for taking my question. Just on a related note from the previous question. So historically your strength has been in unstructured environments. And of course, with the Cyral acquisition and increased focus on Snowflake, Databricks, BigQuery, [indiscernible] (00:52:30) into structured data. Just curious, Yaki, like how are customers responding to this kind of more unified view across structured, unstructured assets? Do you see this more of a greenfield expansion, and are there like real gaps in automated remediation there? Are you seeing budgets kind of shift from potentially legacy kind of asset management vendors into your platform? Just curious what you're seeing. Thanks.

Yaki Faitelson

Chief Executive Officer, President, Co-Founder & Chairman, Varonis Systems, Inc.

A

Yeah. I think that for organizations it is just, it's natural to make sure that they are protecting all the data. With us they need all the automated outcomes that we provide. They want one unified classification engine, and this is exactly what they need from us, which is getting much better security. We had second to none data-centric user behavior analytics. We also work a lot on the, in active directory [ph] enter ID (00:53:25), Okta, IAM, so monitoring identities and other streams like firewall [indiscernible] (00:53:32). So this is just natural extension for them. It works very well for them to make sure that they don't have data breach to make sure that they are in compliance, and they can do it in an effortless way, but also that they can go and show the board, the superior that they have done a good job, that in a tangible way they classified everything, they label it, now the blast radius without breaking business bosses, and they did everything automatically without adding any additional head count.

Operator: The next question we have is from Jonathan Ruykhaver of Cantor. Please go ahead.

Jonathan B. Ruykhaver

Analyst, Cantor Fitzgerald & Co.

Q

Yeah. Hi. Can you talk about the agentic AI capabilities that you've announced within MDDR? And specifically, when you look at agentic systems, the adoption curve is still very early. So when would you expect agentic AI to actually begin to contribute more materially to customer outcomes in revenue growth? And specifically, as it relates to MDDR, how do you plan to monetize those new features?

Yaki Faitelson

Chief Executive Officer, President, Co-Founder & Chairman, Varonis Systems, Inc.

A

Thanks for the questions. What is happening, we have world-class analysts looking at customer data 24x7, and we also have a very unique dataset that features the behavior of user and service account and all identities into the data, and [indiscernible] (00:55:09) a lot of information. But what we did, we just learn how to build these security agents that looking at the data and can close everything, takes a lot of events and many alerts and just close them automatically to make sure that the analyst can be extremely productive.

So once a customer is on boarding with MDDR, you have the best analysts in the world using a data-centric platform, and just an army of robots that is helping them in a tireless way to look 24x7 at the customer's environment and make sure that they don't have a data breach, and it works extremely well. We are getting to tremendous automation, and this is how we are augmenting analysts. And once you have our MDDR, an extension of your team is the best people in the world of understanding data security that are working for you around the clock with the help of [indiscernible] (00:56:06).

Operator: Thank you. Ladies and gentlemen, we have reached the end of the question-and-answer session. And I would like to turn the floor back over to Tim Perz for any closing remarks.

Tim Perz

Vice President-Investor Relations, Varonis Systems, Inc.

Thanks again for the interest in Varonis. We look forward to seeing you all at conferences this quarter.

Operator: Ladies and gentlemen, that concludes today's conference. Thank you for joining us. You may now disconnect your line.

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