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JFrog Ltd.

Second Quarter 2024 Financial Results

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JFrog Ltd.; Vice President, Investor Relations

Shlomi Haim

JFrog Ltd.; Chief Executive Officer and Co-Founder

Ed Grabscheid

JFrog Ltd.; Chief Financial Officer

PARTICIPANTS:

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JPMorgan; Analyst

Ryan MacWilliams

Barclays; Analyst

Sanjit Singh

Morgan Stanley; Analyst

Koji Ikeda

Bank of America; Analyst

Kingsley Crane

Canaccord Genuity; Analyst

Michael Cikos

Needham; Analyst

Brad Reback

Stifel; Analyst

Andrew Sherman

TD Cowen; Analyst

Miller Jump

Truist Securities; Analyst

Jeff Hickey

UBS; Analyst

Jason Ader

William Blair; Analyst

Yi Lee

Cantor Fitzgerald; Analyst

Robbie Owens

Piper Sandler; Analyst

Nicholas Altmann

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PRESENTATION:

Operator^ Ladies and gentlemen, thank you for joining us. And welcome to JFrog's Second Quarter 2024 Financial Results Conference Call. I'll now hand the conference over to Jeffrey Schreiner, VP, Investor Relations. Jeffrey, please go ahead.

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Jeffrey Schreiner^ Good afternoon. And thank you for joining us as we review JFrog's second quarter 2024 financial results, which were announced following market close today via a press release. Leading the call today will be JFrog's CEO and Co-Founder, Shlomi Ben Haim; and Ed Grabscheid, JFrog's CFO.

During this call we may make statements related to our business that are forward looking under federal security laws and are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 including statements related to our future financial performance and including our outlook for Q3 and the full year of 2024.

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

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

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

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

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

Additional information will be made available in our form 10-Q for the quarter ended June 30, 2024, and other filings and reports that we may file from time to time with the SEC.

Additionally, non-GAAP financial measures will be discussed on this conference call. These non-GAAP financial measures which are used as measure of JFrog's performance, should be considered in addition to and not as a substitute for or in isolation from GAAP measures.

Please refer to the tables in our earnings release for a reconciliation of those measures to their most directly comparable GAAP financial measures. A replay of this call will be available on the JFrog Investor relations website for a limited time. With that, I'd like to turn the call over to JFrog's CEO, Shlomi Ben Haim. Shlomi?

Shlomi Haim^ Thank you, Jeff. Good afternoon to you all and thank you for joining our call. Q2 was a productive quarter for JFrog, demonstrating solid results in our revenue, gross margin, free cash flow and EPS.

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We extended JFrog on all fronts, evolving into a provider of a comprehensive software supply chain platform fortified by enhanced security capabilities that are being adopted by the world's leading organizations. Our total revenue for the quarter was \$103 million, up 22% year over year.

We are successfully transitioning to strategic outbound enterprise sales and increasing our average selling price, all while achieving an impressive business efficiency. Our performance highlights the sustainability of our business. As we expand our platform.

Infused with innovation aligned with current and future market demands, JFrog plays a crucial role in organization software supply chain flow, encompassing DevOps, DevSecOps and now MLOps.

During the second quarter, JFrog's cloud revenue reached \$39.3 million representing a 42% year-over-year growth. Ed will further discuss our cloud business and dynamics on today's call. Throughout the past year, we added 115 net new logos to the greater than \$100,000 ARR category.

In Q2, JFrog's customers in this category grew to 928 up from 813 in the previous year. The number of customers with an ARR exceeding \$1 million increased by two during the quarter, reaching a total of 42, which represents 75% year-over-year exceptional growth.

This enterprise growth numbers are the results of our successful shift from a purely inbound inside sales model to a hybrid approach that combines enterprise sales with bottom up inbound sales. The rewards of this shift to enterprise sales are evidenced with an increase in ASP for both new and existing customers.

However, high TCV deal cycles are taking longer than anticipated due to budget constraints. This reality will be addressed as we look into the second half of 2024. Our 97% exceptional growth retention rate indicates that the vast majority of our customers consistently choose JFrog on every renewal.

Given the innovation added to our platform with new capabilities and significant portion of our customers base that has yet to upgrade to the full platform, we believe we can deliver durable expansion in the future. Based on first half results, the strict budget environment, rigid procurement processes, longer sales cycles and projects being delayed, we anticipate slower growth in customers expansion for the time being.

With that, let me address ongoing adoption of the JFrog platform by some of the world's most influential companies. A little over three years ago, we embarked on the journey of creating a software supply chain platform centered around Artifactory, which has become the gold standard for software packages, single source of food and database of DevOps.

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We developed a holistic solution now coupled with security capabilities that cater to various enterprise personas and expand our offerings and total addressable markets.

For example, one of the world's big four accounting firms recently chose JFrog as their strategic partner to scale, secure and deliver the software components. After experiencing multiple security breaches in the past, they noted their prior security solution couldn't scale and did not holistically protect their software supply chain.

Working with our technical team, they were able to architect and begin execution on a security driven deal to elevate their security posture, migrate to the cloud with JFrog advanced security and JFRog curation while displacing a competitive solution.

In another new logo deal, one of the United Kingdom's top insurance service organizations, Admiral, migrated to the JFrog platform away from Sonatype Nexus suite of tools.

As they sought to move to a hybrid infrastructure and consolidate their security offerings, they discovered JFrog's comprehensive security suite was a match for their needs, a robust single system of records for binary management.

Admiral's head of capabilities for DevOps and applications, Kevin Foley, noted "With JFrog, we're embracing a strategic partner that allows us to modernize to a cloud-based scalable solution. JFrog is aligned with our mission to modernize and enhance security across our development processes with its comprehensive cloud-based DevSecOps platform.

It empowers us with end-to-end security capabilities crucial for maintaining the integrity and security of our software products." As more companies discover the power of the JFrog platform with Artifactory at its core infused by security and machine-learning solutions, we anticipate driving unmatched value for large scale enterprises.

I would now like to address one of our strategic partnerships. JFrog continues to revolutionize the domains of DevOps, DevSecOps and MLOps.

In Q2, we completed and publicly announced the first phase of a strategic partnership with GitHub, the leader in source code management and AI-assisted development technologies. This collaboration was driven by strong demand from our joint customers including AT& T, Fidelity, Ansys and Morgan Stanley to name a few, who desired a seamless native workflow between these two best of breed platforms, GitHub for source code management and JFrog for binary management.

We were proud to co engineer this pain-solving solution with GitHub and excited to launch the first phase of a deep integration between our platforms that begins to marry the world of code and binaries in a single platform experience.

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Once the integration is completed, we expect to see contributions to the business that will drive JFrog advanced security growth as a result of the tight integration with GitHub advanced security.

Additionally, we anticipate higher shift left exposure to the SMB and AI market due to the GitHub's developers relations and co-pilot solutions.

John Nattle, Director of Technology for AT&T, noted, beyond DevOps and DevSecOps practices, the future will require advanced interactions with AI tools. Chatting with GitHub co-pilot to select the right and secure software package based on the extensive metadata sold in JFour catalog, can be a game changer. This integration will significantly enhance the efficiency of co-pilot users across the software supply chain, binary focused and code environments. The partnership offers the best of both worlds.

At our upcoming user conference swampUP, we are excited to welcome GitHub to our keynote stage to unveil the next phase of integrations including co-pilot AI and advanced security capabilities.

Finally, the expansion of our platform goes beyond DevOps and DevSecOps. I'm excited to share more about our acquisition of Qwak AI and our expansion into the world of MLOps and AI-powered software.

In late June, we announced that we would be acquiring the MLOps platform company, Qwak AI in a deal that was finalized in early Q3. With this acquisition, JFrog is the first company to offer a comprehensive end-to-end every op solution for developing, securing and delivering both traditional and AI-powered application in one platform.

With Qwak's platform to build, train and experiment with the model JFrog Artifactory as the model registry of choice, and with JFrog X-ray and advanced security, protecting the machine-learning lifecycle into production, we believe the JFrog platform is uniquely positioned to bring data scientists and machine-learning engineers the same level of agility, reliability and efficiency as developers and DevOps engineers already enjoy.

Our teams look forward to building an integrated solution to offer our users comprehensive coverage across DevOps and MLOps lifecycles. To the Qwak team, welcome to the swamp.

We are now one, united not only as a team, but also as the creators of the first platform to unify the world of developers, machine-learning engineers and data scientists.

Before we dive deeply into the financials, I want to take a moment to welcome our newest Board member, Luis Visoso. Luis' experience as the CFO of Unity, AWS and Palo Alto Networks, along with his role as an independent Board director at companies like Splunk, will be invaluable to the growth and scale of JFrog.

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I look forward to working with him and having him on board. With that, I'll turn the call over to our CFO, Ed Grabscheid, who will provide an in-depth recap of Q2 financial results and update you on our outlook for both Q3 and full fiscal year 2024. Ed?

Ed Grabscheid^ Thank you, Shlomi. And good afternoon, everyone. During the second quarter of 2024, total revenues were \$103 million, up 22% year over year.

Our second quarter results were within range of our guidance across all measures. Customers continue to highlight the need to consolidate their software supply chain tools towards a best of breed platform solution such as the JFrog platform plus security and now MLOps with the recent acquisition of Qwak AI.

As noted by Shlomi, cloud revenues in the quarter equaled \$39.3 million, up 42% year over year, representing 38% of total revenues versus 33% in the prior year. Self-managed revenues or on-prem were \$63.8 million, up 13% year over year during the second quarter.

We anticipate self-managed revenue growth trends to slightly decline in 2024 compared to 2023 as customers waiting to migrate to the cloud have paused investment in their on-prem deployments. Net dollar retention for the four trailing quarters was 118%, in line with our guidance.

Our gross retention rate remained at 97%. In Q2, 50% of total revenue came from Enterprise Plus subscriptions, up from 45% in the prior year. Revenue contribution from enterprise plus subscriptions grew 35% year over year.

Now I'll review the income statement in more detail. Gross profit in the quarter was \$86.9 million, representing a gross margin of 84.4% compared to 83.6% in the year-ago period. The increase in gross margin relative to the year-ago period is due to the elimination of outsourced costs derived from synergies related to the acquisition of VDOO and ongoing cost discipline efforts.

We reiterate expectations for annual targets remaining between 83% and 84% in the near future, then trending towards the low 80s aligned with our long-term model and cloud growth.

Operating expenses for the second quarter were \$73.3 million, up \$2 million sequentially equaling 71.1% of revenues, up from \$62.2 million, or 73.8% of revenues in the year-ago period.

We remain focused on expense discipline while absorbing the operating expenses through our acquisition of Qwak and continuing to maintain the proper level of investment in scaling our enterprise sales team, channel partner ecosystem and strategic R&D spending.

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Our operating profit in Q2 was \$13.6 million, or 13.2% operating margin compared to an operating profit of \$8.2 million, or 9.7% operating margin in the year-ago period, an improvement of 3.5 percentage points. Diluted earnings per share equaled \$0.15 based on approximately 115.2 million weighted average diluted shares compared to \$0.11 per share in the prior year on 108.1 million weighted average diluted shares. Turning now to the balance sheet and cash flow, we ended the second quarter of 2024, with \$591.3 million in cash and short-term investments, up from \$579.6 million as of March 31, 2024.

Cash flow from operations was \$16.7 million in the quarter. After taking into consideration our CapEx requirements, free cash flow was \$16 million, or 15.5% free cash flow margin.

We remain committed to our free cash flow margin targets provided within our long-term model, implying an estimated midpoint of 28% over the coming years. As of June 30, 2024, our remaining performance obligation totaled \$272 million.

Now I'd like to speak about our outlook and guidance for the third quarter and full year of 2024. For the third quarter, we expect revenues to be in the range of \$105 million to \$106 million.

We forecast non-GAAP income from operations to be in the range of \$10 million to \$11 million and non-GAAP net income per share to be in the range of \$0.09 to \$0.11 based on 115 million estimated diluted weighted average shares outstanding.

For the full fiscal year 2024, we expect revenue to be in the range of \$422 million to \$424 million, non-GAAP income from operations to be in the range of \$52 million to \$54 million and non-GAAP net income per share to be in the range of \$0.54 to \$0.56 based on 116 million estimated diluted weighted average shares outstanding. Let me provide more context around our guidance.

The revised guidance for fiscal year 2024 reflects a more challenging macroeconomic environment entering the third quarter, lower anticipated cloud revenue growth and changes in customer purchasing habits. We anticipated our cloud revenue to achieve mid-40s year-over-year growth in 2024.

However, we experienced customer migrations being postponed during the second quarter, a pronounced slowdown in cloud consumption for our monthly subscribers who have no usage commitments, coupled with increased macro uncertainty, we now expect cloud revenue growth to slow relative to prior expectations. Given the macro uncertainty, headwinds within our monthly cloud subscribers and derisking future enterprise customer migration projects in the second half, we now believe full year 2024 cloud growth will be around 40%.

We would note that our revised cloud growth still represents strong execution in a challenging market.

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We continue to see security becoming a critical driver of larger customer deals and view the JFrog platform combined with security as the industry's choice for enterprise customers looking to manage and secure their software supply chains, and consolidate point solutions.

We remain optimistic that JFrog advanced security and curation will deliver durable revenue growth in the future. We're stepping into the second half of the year with a solid sales pipeline.

However, given longer sales cycle and proof of concept processes in a challenging purchasing environment, we now anticipate material revenue from our security core will be achieved in 2025. Given the noted changes compared to our prior expectations, we now believe our net dollar retention range for the full year is likely in the mid-teens versus the high-teens expectation we had exiting the first quarter of 2024.

Finally, the acquisition of Qwak closed in the beginning of July. We do not anticipate any meaningful revenue contribution in the third quarter or for the full year 2024.

As we integrate Qwak into JFrog, we will provide further updates regarding our anticipated contribution to growth and profitability. Now I'll turn the call back to Shlomi for some closing remarks before we take your questions.

Shlomi Haim^ Thank you, Ed. Last week, we marked 300 days since the war in Israel began. We continue to pray for the safe return of the 115 hostages still held in underground Gaza and for more peaceful days in the region and the world.

In the face of these geopolitical and macroeconomic challenges, I'm honored and proud to work with a team that remains steadfast in pursuing our company's strategic goals and upholding the culture that drives us forward.

Frogs, you continue to inspire me daily and I thank you for the effort, devotion and commitment to building and growing our company.

The world depends on the seamless flow and trusted delivery of rapid software updates, whether through DevOps practices reinforced by holistic software, supply chain security capabilities, or MLOps powered by machines. The JFrog platform is engineered to address one of the world's greatest challenges, ensuring software runs efficiently and securely from developers to the edge.

We are excited about the future and the limitless possibilities it holds for us. With that, thanks for attending our call and may the frog be with you. Operator, we are now open to take questions.

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

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Pinjalim Bora^ I just wanted to understand a little bit more on what transpired. You had reaffirmed guidance, I think, about five days remaining in the quarter. Did you notice the changes in the sales cycle dynamics mainly in the month of July. Did it deteriorate towards kind of the end of July? Maybe help help us think through that.

Ed Grabscheid^ Pinjalim, this is Ed.

We noticed a push out in the final few days of the quarter and a remarkable change in the macroeconomic environment in the first month of the new quarter.

So therefore, we didn't see much during Q2 until the final days of the quarter.

We also noticed in that time, strategic deals, significant large strategic deals being pushed out, which indicated to us a change in the purchasing environment. Therefore, we revisited our forecast and derisked and adjusted our guidance going forward for the full year as well.

Pinjalim Bora^ Yes, understood. And one more question on the cloud revenue guidance coming down five points.

Is it possible to understand how much of that is driven by the monthly cloud part as and the annual cloud?

Ed Grabscheid^ So the monthly subscribers for cloud growth is around two to 3 percentage points.

Shlomi Haim^ If I may remind you Pinjalim, cloud subscribers have no commitment, so it's a pay as you go and it's very much aligned with what Ed articulated regarding the macro environment.

Operator^ Up next, we'll take a question from Ryan MacWilliams, Barclays.

Ryan MacWilliams^ Just on the Microsoft partnership.

From what we heard so far, it seems like this is more than just a sales and go-to market partnership, but also more on the product side.

So Shlomi, we'd love to hear what you think this JFrog GitHub partnership means from a product standpoint for the customers. And how do you think about the potential opportunity, their size of this opportunity for JFrog going forward?

Shlomi Haim^ Obviously every partnership, especially with the best of breed other platforms, when it's driven by customers' demand and our biggest customers joint customer demand, it

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shows the rapid adoption of both tools and the expectation from the market to have a one platform experience.

So we have high hopes.

We released the first phase of this integration a bit more than a month ago and we are going to complete this phase with the announcement that swampUP next month in Austin, Texas.

We are very much excited about it.

We like co-engineering with GitHub and we hear the customers excited about this, so we have high hopes.

I think it's too early to say how it will change the narrative and the adoption, but with everything that happens in our environment, DevOps, DevSecOps environment, this integration around DevOps security and AI is what our joint customers expect.

Ryan MacWilliams^ Appreciate the color. And then for Ed, is there a way for us to think about the historical contribution to cloud revenue growth from existing customers moving over from on-prem? And then for the customers that are now delaying their cloud transition, is this something that is put on pause, like slipped from 2Q to 3Q or just something that they're going to maybe relook at in a better macro in 2025 and so on?

Ed Grabscheid^ First, for those customers that are migrating from self hosted to cloud, we see anywhere from 20% to 80% in terms of an uplift in the subscription, therefore providing an increase in expansion for those customers. Regarding the timing of that and the push outs that we saw, we looked at our forward-looking forecast and we derisked for any migrations going forward at this point.

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

Sanjit Singh^ I wanted to go back to where you saw the weakness.

So we've talked about migrations and the monthly pay-as-you-go cloud business, in terms of like whether it's enterprise mid market versus SMB, or geographic exposures, or even across different industries, were there any particular segments that stood out that drove the incremental weakness or what you saw towards the end of the quarter going into July, was that broad based?

Shlomi Haim^ Sanjit, this is Shlomi. No. It goes across geographies, customer's profile, different demands, whether it's security or DevOps.

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It's more about budget concern and it's more about rigid procurement environment. This is what we hear from our customers.

Sanjit Singh^ Understood. And then on sort of the timing of the contribution of advanced security, I guess I'd be a little bit surprised why it would push out.

I mean you obviously have the GitHub integration coming online, but globally, we just had a major outage with the CrowdStrike situation.

So it would seem to me that the focus on the software supply chain and how we roll out updates becomes more critical than ever. And I would have expected a potential tailwind to the business from big outages like that in the second half.

So any reason behind the push out of advanced security and maybe just the broader business not saying more of a benefit post a pretty material global outage that the industry is experiencing?

Shlomi Haim^ Yes, Sanjit, I can share with you what we hear from our customers and what led us to look again at the expectation. When we entered 2024, we thought about early adoption of our security solution.

What happened was that most of our strategic customers started to look at the consolidation of point solutions, which was higher than expected in TCV perspective.

So we are looking at higher potential.

But then again, higher potential also leads to longer proof of concept processes and longer procurement processes.

And this is why we want to be a bit more conservative about the security. With regard to GitHub, the security piece is something that will be announced next month as I mentioned, and then we hope that it will generate even more motivation for consolidations of point solution to the platform security solution.

Operator^ Koji Ikeda from Bank of America has the next question.

Koji Ikeda^ I wanted to follow up to the first question that was asked in the Q&A and really try and understand a little bit more about the linearity of cloud deals. With the guidance that was given on 6/25 [ph], you guys mentioned, the demand environment deteriorated in the final few days of the month, just even coming off the first quarter results, I think one of the big debates on JFrog is understanding how this cloud component is consumed.

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So is that typically how the buyers are consuming cloud? It comes in big in the final few days of the quarter or the month.

Is that the way we should be expecting how the users are buying this product?

Ed Grabscheid^ So the seasonality of purchasing in the quarter we'll typically see towards the end of the quarter.

So majority of deals are done in the end of the quarter. This is something that is not unique to Q2.

We see that every quarter with the majority of that.

In terms of what we're seeing around large migration deals, it's specifically around what we saw during Q2 was that decisions that we felt were high probability with proof of concepts that were completed, those were pushed to later periods.

We re-evaluated, as I mentioned our forecast.

We derisked these large deals based on a very challenging macro environment, rigid purchase environment. Therefore, in the second half, where we had significant migration deals, those have been removed from our forecast going forward.

Koji Ikeda^ Okay. And then to follow up on that, with the revised guidance for the full year on the cloud, that does imply somewhere around a mid 30s growth rate in the cloud for the second half. And so it sounds like you've taken out a bunch of the migration assumptions.

But is there anything else within that guidance that you're taking into consideration aside from the migrations for that cloud number?

Ed Grabscheid^ Sure.

In addition to that, because of the macro environment and this rigid purchasing environment, we're not seeing the level of expansion that we expected in the second half. Therefore, the combination of the migrations and expansion on renewals are being factored into the guidance going forward.

Shlomi Haim^ Koji, if I may add to it, we are looking at 40% growth year over year in the cloud.

We are looking at a profitable business here.

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We have to be conservative and to think about what the market is telling us and therefore in a very responsible way, we looked at our pipeline and the big projects that the pipeline introduced and reacted based on what we saw in the first half of the year.

Operator^ We'll go to our next question from Kingsley Crane, Canaccord Genuity.

Kingsley Crane^ So I want to return to the cloud guide that everyone's talking about. You know it makes sense that you saw some changes and you want to be conservative. The new guide, I still believe would imply sequential re-acceleration in the back half.

So just want to get a sense of how derisked the guidance is here. And then what's the risk that this could deteriorate further despite the conservative take we've taken out here?

Ed Grabscheid^ So what we know today, we feel comfortable with the number that we're presenting around 40% year-over-year growth in the cloud, which Shlomi had mentioned and I mentioned during the call still represents a very good year-over-year growth in the cloud. 2% to 3% of that decline is coming from our monthly customers that do not have commitments with us, and we've stated that in the past.

In addition to that, we've taken a very close look at our forecast going forward and derisk as much as we felt comfortable with derisking any deals in our pipeline and in the forecast for the second half of 2024.

Kingsley Crane^ Okay. That's helpful. And Shlomi, just one for you. You know it's great to hear about the GitHub partnership and how it can help Copilot users bring the best of both worlds. Just want to think through some of how it could translate to business impacts.

Is this sort of a nice feature for existing users, how much of this can be an on ramp for GitHub's large user base to explore JFrog?

Shlomi Haim^ I think Kingsley it's relevant to any organization that is using GitHub or JFrog first and then to any organization that might migrate from Bitbucket or GitHub.

So obviously the potential is very high, mainly because of the fact that it also brings some differentiators that other vendors cannot provide, like enhanced security consolidation with these two platforms, Copilot and JFrog security collaboration.

So users can actually chat with Copilot and get binary information. The collaboration with GitHub is based on our customers feedback, so I don't see how this can go wrong. And also the trend in the market for consolidation moving from point solutions to build a grid platform.

We are very honored and very excited about this partnership.

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Operator^ The next question comes from Mike Cikos, Needham.

Michael Cikos^ I know my colleagues and I are all a little confused by the 40% growth that we're calling out for cloud. And just to put a finer point on it, I wanted to get a sense, does guidance currently contemplate a lift in Q4 for true-ups under these take or pay commitments, like what we experienced in Q4 '23? Does that help explain some of the growth dynamics in the second half of the year we're looking at?

Ed Grabscheid^ Mike, this is Ed.

As we move our cloud customers from an annual use it or lose it to a monthly use it or lose it, we would expect over time that we would have fewer true-ups. Therefore, we don't see as large of a true-up during Q4 of 2024 as we did during 2023.

So I wouldn't expect the same level of what we saw during 2023.

Michael Cikos^ Okay, but just to be clear, there is an anticipated benefit of some sort that's currently baked into this guide we have today.

Ed Grabscheid^ No. We do not consider that.

Michael Cikos^ Okay. Thank you for closing the loop on that. And then I did just want to come back to some of the comments there on the weakness or the changes in behavior that were showing up.

Since I know Shlomi, in the prepared remarks you had cited the increased ASPs and the higher TCV deals.

Can you help us think about like for those delayed cycles, is it more prevalent for those larger tickets or it's really across the board.

We're calling out like the monthly for the cloud users, but any more granularity as far as these different customer segments would really be helpful.

Shlomi Haim^ Yes. It's across the board. Geographies, different customers, different industries, different sectors. And not only that, but also DevOps and Security, which lead us to understand that it's more about the procurement habits than the technology demanded, the successful proof of concept.

What we see, however, that higher TCV requires a longer process.

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So sales cycles are longer when you deploy more funds in today's environment, if it was under \$100,000, maybe it would be easier, but when you consolidate a set of tools around the platform, it leads to a higher TCV.

This is the good news, but it takes longer. This is not such a good news.

We want to be conservative and this is why we implement what we see in H1 on the projection of H2,

Operator^ Brad Reback from Stifel has the next question.

Brad Reback^ Ed, can you remind us what percent of the cloud is month to month?

Ed Grabscheid^ Yes. The percentage is approximately 25% of our cloud business monthly.

Brad Reback^ Okay. And I guess just going back at it last quarter, you were fairly adamant that the mid-40s would be achieved just on your commits.

What changed?

Ed Grabscheid^ Yes what we saw last quarter was visibility into a pipeline that had significant migration deals. That has been derisked.

In addition to that, the purchasing and rigidity of the purchases have certainly changed the monthly consumption, which again, do not have commitments.

We saw a significant decline in those monthly customers. Both of those factors are being taken into consideration going forward.

Therefore, we've made that adjustment to our cloud growth.

Operator^ Andrew Sherman from TD Cowen has the next question.

Andrew Sherman^ Following up on Brad's question there, we're all kind of scratching our heads on the same topic obviously but just want to be clear that the 40% now has no migrations assumed in it and it's all committed with no SMB, no usage.

So the 40% should be the bottom, if you will.

Shlomi Haim^ 40% is yet a very significant growth.

So of course, we assume that some migrations will happen.

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But we derisked the big strategic migrations and we are looking at what we've learned from the second quarter and this is why we adjust.

Andrew Sherman^ Okay. And is there something that happened in June, industry-wide, that may have slowed migrations kind of across the board? You're not the only vendor that's called this out, but what changed abruptly, budget-wise or cloud migration-wise, in June, do you think?

Shlomi Haim^ Yes. Well it's not even June.

It's the last week of the quarter, the last few days of the quarter, when we started to see that more of these strategic big projects are being pushed. And yes, you heard it from not only JFrog, you heard it from the market.

We saw the same.

It's mainly around budget constraints and procurement processes.

And this is why we took act based on what we saw in the last few days of the quarter.

Operator^ The next question comes from Miller Jump, Truist Securities.

Miller Jump^ I guess last quarter you guys called out digestion in the customer base.

I'm just curious, did this quarter have a continuation of that theme as a headwind in addition to the deal cycle changes, or did you see improvement there?

Ed Grabscheid^ We did not see anything related to digestion.

What we're seeing is customers that are delaying purchasing decisions.

We saw that towards the last week of the quarter.

We're now starting to see optimization in terms of their spend as they continue to think about this uncertain macro environment, the very rigid purchasing environment that we're faced with.

But we didn't see anything related to a digestion.

Miller Jump^ And then I actually might come back to you on this one as well Ed. Just given the cut to guidance.

It looks like now we're in a position where you need to see a re-acceleration at the low end of your FY'27 revenue targets.

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Can you just talk about the drivers and more specifically, the timing of how you see that playing out from here?

Ed Grabscheid^ Yes.

So first off, we changed our guidance only 1%.

So we went from 22% to 21% on our annual guidance. And we continue to maintain our focus on execution of the three pillars, or the three legs of the stool of our long-term model, which is adoption of full platform, migration to the cloud, and of course, security.

So based on those factors, and the fact that we have not baked in the potential tailwind that we may get from AI and MLOps, when we think about that in the long-term model, with multiple years to go, even though we're faced with a macro environment right now we still feel very confident in the long-term model and the top line growth that we presented in that model.

Operator^ The next question comes from Jeff Hickey, UBS.

Jeff Hickey^ The first one would just be maybe more color just on how customer conversations have been. And obviously your cloud business in general is driven by a project-oriented model. There was, I think, an expectation that in H2, you'd start to see more projects come online as customers got more visibility into their work plans.

Have those conversations evolved? Have those changed in any way, or is it still just a lot more focus on elongated sales cycles, just from a budget procurement scrutiny perspective?

Shlomi Haim^ So customer conversation, if I heard the question right, I'm sorry, it was a bit hard to hear. Customer conversation, what we hear from our customers is the following. The first thing that everybody point to is consolidations of point solution into a platform. There are a lot of our on-prem customers that are speaking about future migration to the cloud.

Obviously this is not happening in today's environment.

And third, that security is embedded into the solution.

So there is no DevOps standalone or security standalone.

It comes together. A lot of them are also pointing the future with what MLOps bring and the fact that they will have to support MLOps with the DevOps practices, so they know that it will be part of those services. And therefore, when we push not only to extend our platform but also to look at the ecosystem, we chose the partners that we want to go with.

So this is what we hear on the technology side.

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What we hear on the procurement and the budget side is that they have to be very strict, very disciplined to their commitment, and also to apply all types of optimization on their cost as long as this situation in the market is going on.

Jeff Hickey^ One quick one for you, Ed. You made a comment earlier.

I want to just be crystal clear on this. You said as we move customers from annual to monthly, we'd expect fewer true-ups.

Is that something that you're witness [ph] like should we expect that 25% of monthly business to shift up as we edge closer to Q4?

Ed Grabscheid^ No. I think, let me clarify the question.

I believe the question was when we move customers from self hosted to cloud, we see an uplift anywhere from 20% to 80%. Customers that move from monthly, which do not have commitments to us, to an annual within cloud, we don't see an uplift in those customers immediately.

But over time, as budgets allow, we would start to see an improvement in the uplift and expansion of those customers.

Operator^ We'll take the next question from Jason Ader, William Blair.

Jason Ader^ I just wanted to ask whether you guys are very confident that there's no competitive issue here or execution issue. You know you talked about macro, I think we all get that.

But you are moving to this new strategic outbound sales model. That's not simple for an organization that never had that. So just wanted to know if you've identified any execution issues on top of the macro issues or competitive.

Shlomi Haim^ This is Shlomi. Well there are a few (inaudible) that we mentioned in the call and need to be kind of taken into consideration.

We said that we have 97% retention rate of our ARR, which suggesting that these customers are not moving or in short is not moving to competitors. The second thing is that I never saw an enterprise customer invest 2, three quarters in a proof of concept and at the end, telling me that they need a bit more time, but then moving to a competitor, we never saw that happening.

In addition to that, when we are looking at our pipeline and we speak with our customers, we don't hear them looking for another solution In the market usually.

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There is always competition, but this is not the narrative that you see in the pipeline. And the last thing is that when you think about the partnership between JFrog and GitHub, think about the CIOs and the CISOs of the market.

Who will go and check something else when the two best of breeds are coming together to provide you with one platform experience? So it's less about the competitive environment, it's more about the macro environment. I'm certain about that. And this is what we hear from our customers as well.

Jason Ader^ All right. Then, a quick follow up on the GitHub partnership.

What do you think their main motivation is to do this deal? Do you think it's the advanced security capabilities that you have that they can now kind of co-sell with and then just, is that special in any way to their range of partnerships? I mean do they have partnerships with other security vendors, for example, that would be sort of an alternative for the GitHub reps to recommend?

Shlomi Haim^ Yes. Well I can speak for myself and I can speak maybe on behalf of my customers of what we've heard from them.

First of all, there are a few differentiators in this partnership. A, it's the binary expertise next to the source code expertise. That's the kind of the long run coming together, binary and source code. The second thing is security, both JFrog and GitHub bring advanced security capabilities, that protect your software supply chain, and we are complementary to each other.

We coexist one next to the other. They protect your source code, we protect your binaries, and it goes together. And it's very appealing to the customers, especially when they can see it on one platform with one view. And the third thing, and this is a very fast growing adoption, Copilot and the AI-driven application is something that requires more insights from the metadata and the binaries and the collaboration between JFrog and GitHub, introducing a chat of a developer with Copilot getting the information from Artifactory and X-ray is very appealing for our customers as well.

So as mentioned in the quote, our customers are driven by consolidation and the differentiations that can come from this collaboration.

Operator^ We'll take the next question from Yi Fu Lee, Cantor Fitzgerald.

Yi Lee^ I guess like my question is multi reconcile.

We see great hyperscaler growth rates this quarter, above average. And in terms, I appreciate a comment on the migration slowdown, I guess, Shlomi and Ed, like what are the dashboards that

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you guys look at on a daily basis, monthly basis, weekly basis to get you more comfortable that the animal [ph] spheres of the CIO, CTOs will continue with that migration going forward.

We just want to get more clarity on that.

Ed Grabscheid^ This is Ed.

So we're always looking at the pipeline. This is an indication of how we believe the forward looking will play out and through those discussions that we have with our customers as well as with the internal sales team.

In addition to that, we also look at behaviors in the market. And based on what we see now and the change in the macro environment, the change in the purchasing environment, and what we see in terms of the derisk of those forecasts, this is how we make the decision.

And this is why we opted to be conservative in our approach and lower our cloud guidance.

Shlomi Haim^ And if I may add to it, when Ed is saying we are looking at our pipeline, it's not just a general number, we are looking at different stages.

What give us the confidence to your question is looking at our pipeline after the technology win. This is also what brought us to the conclusion that we had to derisk those big projects.

So looking at late stage after the tech win before budget discussions, this is the main dashboard that we are looking at.

Yi Lee^ And then my follow up is more of a, if I step out a little bit, I think last month, there were news over chatter of direct competitor GitLab on some M&A activities.

I should say. Your thoughts on the consolidation in this space? Any commentary on that.

Shlomi Haim^ So if the question is about the landscape and the competition with the hyperscale, we see co-selling, co-marketing potential there. And with GitLab specifically, well we don't hear from our customers that they are migrating to GitLab package management solution, no security solution and we don't see any MLOps capabilities with GitLab.

So under 30% of our customers are using GitLab, I guess that this partnership with GitHub is aligning us more with what our customers prefer to see in the future when they speak about consolidation.

But we don't see a lot of GitLab competition in our pipeline.

Operator^ We'll take the next question today from Rob Owens, Piper Sandler.

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Robbie Owens^ I guess just to shift a little bit, would like to ask on the Qwak acquisition from a clarification standpoint. You said no revenue in the expectations moving forward, guessing there is that expense in the expectations.

So can you quantify that number one, and how should we think about integration.

Is this relatively simple from a plug-and-play standpoint, or will this require increased investment over some period of time that we should contemplate margins from that perspective?

Ed Grabscheid^ This is Ed. Yes. We're still in the process. We closed Qwak the first week of July, and we're still in the process of integrating them. There is expense that we're absorbing, and as you know and JFrog has proven history of being very diligent in terms of the way that we manage our expenses and will be continued to be focused on profitability.

The integration, which, as we complete that integration, we will of course, balance the operational efficiency and the ongoing investment. And this will be very much aligned with our expectations from a long-term model as well.

Shlomi Haim^ If I may answer it, Rob. On the integration and the solution to the market, it's not a matter of MLOps, yes or no. It will be adopted. It will be. And as you know and as we announced in the previous quarters, we integrated with MLflow, we integrated with AWS Pagemaker and with Qwak.

So this is based not only on the trends in the market of adopting AI technologies, but also the fact that it's a very logical next leap forward for JFrog. Artifactory is already serving as the model registry of choice. Xray is already scanning your model.

So improving or expanding our platform was a mandatory next step forward for JFrog. And as Ed mentioned, once the integration will be completed, we will also share our expectations with you.

Operator^ And we'll go next to Nick Altmann, Scotiabank.

Nicholas Altmann^ I wanted to follow up on advanced security and curation. Maybe just talk about what gives you confidence this is more macro related or more scrutiny on budgets versus product market fit, given this is a newer product offering. And then secondly, I think historically, we talked about advanced security and curation becoming a material portion of revenue for this year.

I guess, how should we think about the timeline now as to when that can be material to revenue or just any sort of goal post as to what that can contribute this year?

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Shlomi Haim^ Well we came into 2024 very humbled with the adoption. We wanted to see our portfolio starting to look at advanced security and curation. And what we saw is that they are willing to consider a full consolidation around JFrog Advanced Security and JFrog Curation.

We are looking at the pipeline, we are looking at strategic deals. We are hearing about the proof of concept in the world's leading organization.

And this gives me the confidence that it's not only the security solution, but also the movement on point solution and consolidation around one platform, A. B, JFrog Advanced Security is displacing a lot of point solutions, secret detection, infrastructure code, static analysis and so on. JFrog Curation have less competition in the market and it's very innovative based on what we see, it's also appealing not only to the security persona, but also to the DevOps persona. And therefore, we see more interest coming from two directions in the enterprise.

We are looking at the pipeline, we are looking at the size of the deals, we are looking at the names of the customers. We also know that they face their own challenges with this macro environment.

We have patience, but I will take a big deal with a higher TCV any day over a small deal, just to get in somewhere and not to displace my competitor. So this is what we see now and this is why we decided to derisk this project and the pipeline accordingly.

Operator^ Everyone, at this time, there are no further questions. I'd like to hand the conference back to Shlomi for any additional or closing remarks.

Shlomi Haim^ Thank you very much for joining us today. May the frog be with you. And may we have more peaceful [ph] days moving forward. Thank you very much.

Operator^ Once again, everyone that does conclude today's conference. Thank you for your participation. You may now disconnect.