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FEYE - Q2 2014 FireEye Inc Earnings Call

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PRESENTATION

Operator

Good day ladies and gentlemen, and welcome to the FireEye Second Quarter 2014 Financial Results Conference Call. At this time, all participants are in a listen-only mode. Later we will conduct a question-and-answer session, and instructions will follow at that time.

(Operator Instructions)

I would now like to introduce your host for today's conference call, Miss Kate Patterson. You may begin, ma'am.

Kate Patterson - *FireEye Inc - VP, IR*

Thank you very much, and thank you all for joining us today on our conference call to discuss FireEye's Financial Results for the second quarter of 2014. This call is being broadcast live over the internet, and can be accessed on the Investor Relations section of FireEye's website at investors.fireeye.com.

With me on today's call are Dave DeWalt, FireEye's Chairman of the Board and Chief Executive Officer; and Michael Sheridan, Senior Vice President and Chief Financial Officer. After the market closed, FireEye issued a press release announcing the results for the second quarter of 2014.

Before we begin, let me remind you that FireEye's Management will make forward-looking statements during the course of this call, including statements related to FireEye's guidance for the third quarter of 2014 and the full year 2014, industry growth drivers and customer adoption of our solutions, continued revenue growth and momentum in FireEye's business, trends in FireEye's business operating results and customer wins, the general availability and expected capabilities and benefits as new FireEye products, and the integration of Mandiant and nPulse technologies.

These forward-looking statements involve a number of risks and uncertainties, some of which are beyond our control, which could cause actual results to differ materially from those anticipated by these statements. These forward-looking statements apply as of today, and you should not rely on them as representing our views the future, and we undertake no obligation to update these statements after the call.

For a detailed description of the risks and uncertainties, please refer to our 10-Q filed with the SEC on May 14, as well as our earnings release posted a few moments ago to our website. Copies of these documents may be obtained from the SEC or by visiting the Investor Relations section of the website.

Also, please note that certain non-GAAP financial measures will be discussed on this call. We have provided reconciliations on these non-GAAP financial measures for the most directly comparable GAAP financial measures in the Investor Relations section of the website, as well as in the earnings release. With that, I will turn the call over to Dave DeWalt.

Dave DeWalt - *FireEye Inc - Chairman, CEO*

Okay, Kate, thank you. Greetings, everybody, and welcome to our Second Quarter 2014 Earnings Call. I'm very pleased to report that FireEye delivered another strong quarter of billings and revenue growth in Q2, exceeding the guidance ranges for both. Our overall growth rate on a year-over-year as reported basis was 153% for billings and 184% for revenue. We also reduced our operating losses as a percentage of revenue, and posted non-GAAP loss per share below our expected range of $0.58 to $0.63 per share.

In addition, our outlook looks strong, and we're raising our guidance for the full year 2014 on the key metrics of billings, revenue, and loss per share. This marks the fourth consecutive quarter of beating and raising our top-line metrics, as the adoption of FireEye's industry-leading security technologies continues to expand.

We also more than doubled our install base of customers compared with a year ago. I believe this growth reflects proof that today's security architectures are ill-equipped to address tomorrow's threats. Point products, no matter how advanced, simply cannot provide the rapid detection and response necessary to contain and prevent the types of threats we see every day now. This is the reason we invested in building a comprehensive security platform, and why we expanded our global infrastructure and service capacity.

As we look at the competitive landscape today, there's no other Company that can compare with FireEye in terms of its diversified blue-chip customer base, the depth of threat intelligence from that customer base, the breadth of products and services, and established global infrastructure. These are competitive advantages that will continue to fuel our growth as we enter the next phase of our evolution from an advanced security pioneer to the industry leader.

I want to take a minute to review the tremendous progress we've made over the last 12 months. Then I'll outline some of our Q2 highlights, which will show the momentum FireEye is having in the market place. Lastly I want to speak to the next phase of our growth.

It has now been almost a year since our IPO, and we're a much different Company today than we were last September. In the last four quarters, we more than doubled the number of FireEye protected customers, growing our install base from 1,182 customers to nearly 2,500 customers today. Our customers include some of the most important organizations in the world, in industries such as banking, telecom, energy, transportation, retail, and probably most influential, more than 50 global governments' military intelligence operations.

Our customer base is perhaps our most important asset. These organizations are the most frequently targeted networks in the world, giving us unparalleled visibility into the threat environment. We also build to worldwide sales, service, and support infrastructure, with a presence in 65-plus countries to support a growing install base.

We also built a global engineering organization that enables continuous innovation in nearly every continent. These investments resulted in an industry-leading net promoter score of 54, compared with a software industry average of 35. The net promoter scores are independent surveys that reflect overall satisfaction, quality, and support of our products.

Additionally, to further extend our market reach and achieve greater leverage from our sales and marketing investments, we expanded and improved our partner programs. As a result, we increased the number of registered partners by more than 300% year over year, and the value of partner-generated pipeline by more than 200%. We also acquired several companies, including Mandiant and nPulse, extending our lead in many new and important areas of the security market.

Finally, through the efforts of our engineering, threat research, and infinite response teams at the combined Company, we accelerated our new product engine, and transformed FireEye from a Company with just two network-based products a year ago to one with 20-plus products today, integrated across the Endpoint network and the cloud, all wrapped with a suite of services, including our Managed Defense offering, which is now deployed worldwide.

Speaking of acquisitions, the people, products, and threat intelligence of Mandiant played a powerful role in this transformation on many levels. The addition of Mandiant 's infinite response and threat research capabilities took our threat intelligence to the next level. With the detailed contextual information Mandiant has accumulated on threat actors and their methods, we're better able to identify and respond to zero-day attacks.

This capability has now allowed us to deliver a new cloud subscription service to our products, called advanced threat intelligence or ATI, that complements and extends our existing dynamic threat intelligence service that FireEye offers today. This product is just now shipping live, and will be launched this summer.

Moreover, Mandiant's people and technology are also enabling other new products and services, extending our advanced security platform to the Endpoint, and adding new Cloud-based services such as TAP, or the Threat Analytics Platform. Industry analysts are saying this is one of the most interesting and innovative products they've seen come out in the industry in a long time.

Finally, Mandiant's respected Infinite Response practice has expanded to our go-to-market strategies with services-led sales models. When we lead with Infinite Response services, the conversion rate for product sales or Managed Defense is very high.

Now we've added nPulse for an end-to-end enterprise forensics platform. NPulse's capability enables FireEye customers to deploy an important area of security technology -- the ability to detect a threat and record critical breaches that can create unprecedented damage if not properly managed.

It's been an amazing journey getting to this point, and I'm extremely proud to have been a part of it. I believe the best is yet to come. As I look to the future, I believe we're at the beginning of the next phase of our growth, a phase characterized by continued high growth and improving financial metrics.

Highlights of the second quarter included the following. We continued expansion of our customer base worldwide, adding more than 243 new customers, compared to 148 in the second quarter of 2013. We also increased the number and the value of deals that included multiple products, including cross-sell of FireEye and Mandiant products.

The new Global 2,000 customers included a well-known multi-national automobile manufacturer, who signed a seven-figure Managed Defense contract; an electrical grid operator in Europe, who funded their purchase of multiple FireEye products with funds earmarked to renew other security products after we demonstrated the value of FireEye platform; and a leading US medical technology company, with operations in nearly 50 countries, also a Managed Defense subscription that followed a successful Infinite Response engagement.

As successful as we have been with the largest of the G2K, or the Global 2,000, there's still plenty of opportunity in this market segment, in terms of both new logos, and the opportunity to cross-sell and up-sell to the existing customers we have.

We also added a record number of new, non-Global 2,000 customers in Q2, which I believe is a direct result of the investments we've made in a our telesales organization, and in our channel program. This proves once again that it's the value of our customers' data and intellectual property, rather than the size of the Company, that drives the need for advanced security.

Looking at the Q2 transactions, there was no particular concentration by any vertical market or size. In the mid-market, customers ranged from law firms, purchasing a single NX or [aweba] plant to reinsurance providers implementing an end-to-end solution that included Web, e-mail, and Endpoint products. We closed deals with retailers, social media, internet companies, financial institutions, universities, government agencies, and cloud-based service providers, to name just a few.

We also saw a growing momentum in our international business, as awareness of advanced attacks continues to increase in these markets, and our international field organization continues to move up the productivity curve. Revenue from international markets was up 189% compared to Q2 a year ago, and accounted for 26% of total revenue.

I've already mentioned a couple of new international Global 2,000 customers. Another notable international deal was our first financial services customer in India. That deal was particularly competitive, as Cisco and Trend Micro both offered large price discounts to prevent us from getting a foothold in the Indian banking market. We were able to demonstrate our technical superiority in the customer-purchased multiple products and services, at much higher prices.

I believe we've hit critical mass in our install base of customers around the world, making it a perfect time to expand our sales leadership. To help take us to the next level, I'm pleased to announce the hiring of John McGee, our new Senior Vice President of Global Sales.

John has a remarkable track record of running $1-billion-plus businesses, having recently helped Informatica grow to over $1 billion in sales, as well as running a multi-billion-dollar business at Adobe, and prior to that, EMC. John brings outstanding experience and leadership in building and scaling a global sales organization. I've known John for 15 years, and I have first-hand experience working side by side with him in the trenches. His passion, energy, and drive for excellence are exceptional.

As the Company moves into this critical next phase of our growth, I'm also very excited to announce that Jeff Williams, our current head of sales, will be staying on as our new Senior Vice President of Americas, reporting to John. In this capacity, Jeff will continue to be a vital part of our global Executive Management Team, and help drive the Company to the next level.

On the product front, we've continued to invest in both platform expansion and enhancements to our existing products, as well as threat-detection technology and threat intelligence. I believe that maintaining this balance between enhancements to existing products, and the introduction of new products, all supported by the industry's most comprehensive threat intelligence, is the key to maintaining our multi-year technology lead in supporting our growth.

In Q2, we introduced an update to our e-mail security products, and launched our IPS solution globally. Both solutions expanded the portion of the total security market we address, and allow us to target existing line items in IP budget, as we go from market creator to market consolidator.

As the first of many add-on products and subscriptions for our existing platforms, our IPS solution is especially important for multiple reasons -- first, it demonstrates the value of our MDX, or our virtual machine technology. By validating alerts in a virtual machine, our IPS reduces thousands of false alerts typically generated by IPS devices. In one example, a large health care organization reduced 1,400 alerts per day to just 40 in a single day. These were all true positive alerts.

Second, the availability of our IPS on our NX or web appliances, begins to transition both our customers and our sales force from a point-product sale to a multi-product platform sale. Finally, the IPS demonstrates the market 's readiness to transfer budget dollars and investment from ineffective legacy solutions to advance security. Still very early in what we anticipate will be a multi-year adoption cycle for IPS. The customers' interest is very high, and in several transactions IPS pulled the rest of the sale.

Looking to the new product calendar in the back half of the year, we're on track with the additional releases for our NX appliance and our Endpoint products. The NX release will include support for the MacOS, for the Apple MacOS, making FireEye the only advanced security platform to protect Apple and Windows from zero-day targeted attacks and multi-protocol call-backs.

The Endpoint release will include a tighter integration with FireEye products and the CMS management platform. It will include strong detection capability now, as well as fully integrated solutions with our network and cloud products. Finally, we'll launch formally our advanced threat intelligence subscription, offering as add-on subscription to our existing platforms.

I wanted to take another minute to emphasize how critical our advanced threat intelligence is. Combined with the expertise of our world-class threat researchers is detecting, containing, and preventing advanced threats. The story of our discovery of the Operation Clandestine Fox attack, initially discovered on April 26, is a vivid example of how our ability to detect new zero-day exploits, contain the threat, and then prevent future attacks through rapid distribution of the resulting threat intelligence at virtual machines and Endpoint sensors across the entire security architecture.

There are multiple detailed blog post on this, but to summarize, we detected the threat in one of our Managed Defense customers, determined it was a new zero-day exploit, and updated our customer's virtual machines with a new threat intelligence in less than 24 hours worldwide. As the campaign morphed over the next ten days, we were able to use our applied threat intelligence to detect the new threats, and protect the 11 other Managed Defense customers initially targeted by the attack.

There's no other security company with the threat intelligence products and services capable of delivering this level of rapid detection, response, and protection. Based on real-world data from trials with more than 1,200 customers around the world, we believe there's no other Company that could have detected these types of attacks.

You can read the detailed statistics in our Maginot Line white paper, but we found that existing security products detected only 18% of the threats, and 90% of the alerts were false positives. FireEye detected, by comparison, 99% of the attacks, finding that 97% of these customers were in fact breached.

A quick side note on Managed Defense, our security-as-a-service platform. Managed Defense was initially introduced by Mandiant to give customers the choice of purchasing product and managing themselves, or having Mandiant manage it through their security operations center. With the acquisition, we expanded this offering to include multiple service levels now, and rolled it out globally.

Initially, we thought it would be most compelling to SMBs or small-medium businesses, who typically do not have in-house advanced security resources of large enterprises. However, as multiple seven-figure Managed Defense transactions in Q2 demonstrate, the offering is equally relevant to the Global 2,000.

I believe these contracts show that the market is right for a new security-as-a-service model. If I'm correct, and Managed Defense adoption continues to accelerate, it will change the game again. This will create a new product and service standard, new go-to-market models, and new partnership opportunities; and we're already exploring a few of those.

To summarize, I believe we're in the early stages of the market's transformation from legacy pattern-matching security to virtual-machine-based threat detection, and from traditional product and consulting models to security-as-a-service model. Whichever direction the market takes at whatever pace, I believe FireEye is well-positioned to succeed with leading technology, our broad product offering, and a flexible business model. On that note, I'll turn the call back over to Mike, and I'll be back in a minute. Mike?

Michael Sheridan - *FireEye Inc - SVP, CFO*

Thanks, Dave. First, I'd like to join Dave in thanking you for your ongoing support and interest in FireEye. Before I begin, I would like to remind you that I will be discussing our non-GAAP financial results and metrics for the first quarter. Specifically, our reported non-GAAP results exclude stock-based compensation, the amortization of intangible assets, acquisition-related costs, and non-recurring tax benefits related to the Mandiant and nPulse acquisitions. Our 2013 non-GAAP financial results also exclude changes in the fair value of the preferred stock warrant liability.

In terms of our financial results, I'd like to begin with a summary of progress made in the quarter on some important initiatives. First, we made significant progress in continuing the integration of FireEye, Mandiant, and nPulse. We increased the number of combine transactions we closed in the quarter. In a few moments I will discuss improvements we are making to our combined spending model in the second half of 2014.

We also made strong progress in growth of our product revenues, which accounted for 40% of total revenues in Q2. On a pro forma combined basis, our product revenues grew at a rate -- at a greater-than-75% rate year over year. Third, we achieved billings growth that exceeded our Q2 guidance, and the analysts' consensus estimate, while at the same time reducing our average contract length on multi-year contracts from 31 months in Q2 of 2013 to 27 months in Q2 of 2014. More specifically, our billings grew to $113.8 million from $45 million, a 153% increase year over year.

There are several key drivers to the billings growth we achieved in the second quarter. First, we continued the rapid expansion of our customer base. Our worldwide customer base grew to nearly 2,500 customers in Q2, from approximately 1,200 customers in Q2 of last year, a 111% increase, and a 59% increase on a pro forma combined basis.

Our total billings growth was further driven by our business model that centers around recurring subscriptions and support. Our recurring subscriptions and support billings grew to $60.7 million, from $25.2 million in Q2, a 140% increase year over year. Our recurring subscriptions and support billings accounted for 53% of total billings in Q2 of 2014.

Historically, recurring subscriptions have been driven by a 100% attach rate of our suite of subscriptions in support to our product sales, and this continued in Q2. In addition, Mandiant's Managed Defense and Threat Analytics platform recurring subscriptions continue to add growth to our recurring subscriptions business. Our product-driven subscriptions and support contracts are paid 100% up front and our non-cancelable. As I mentioned in the second quarter, our average contract length for new orders was 27 months, compared to 31 months in Q2 of 2013.

Within total billings, our product and product subscription billings include the sales of our appliances, our DTI cloud subscriptions, our e-mail URL engine subscriptions, our continuous monitoring subscriptions, and our subscriptions for Managed Defense and Threat Analytics platform.

Our product and product subscription buildings grew to $77.7 million in Q2, from $34.4 million in Q2 of last year, a 126% increase year over year. Our combined renewal rate remained above 90% for Q2, which drove billings growth, and is another indication of the high level of our customer satisfaction in the value provided by our solutions. This rapid rate of growth in our billings continues to increase our visibility into future revenue streams. Our deferred revenues grew to $232 million in Q2, a 24% year-to-date increase over deferred revenues of $187.5 million at the end of 2013.

Turning to revenues, our total revenues grew to $94.5 million in the second quarter, which includes the downward impact of a $2.5-million deferred revenue haircut. This was a 184% increase over $34.2 million in the second quarter of 2013. Our product and product subscription revenues grew to $65.7 million in Q2 2014, from $26.8 million in Q2 of 2013, a 145% year-over-year increase.

On a pro forma combined basis, which eliminates the impact of the deferred revenue haircut, our product revenues, product subscription revenues, and combined product and product subscription revenues all grew at a rate in excess of 75%.

Our customer support revenue grew to $11.9 million, from $6 million in Q2 of the prior year, a 97% increase. Our total subscriptions and support revenue grew to $39.9 million in Q2 of 2014, from $15.6 million in Q2 of 2013, a 155% year-over-year increase. On a pro forma combined basis, which eliminates the impact of the deferred revenue haircut, our total subscriptions and support revenues grew at a rate in excess of 70%.

Our professional services revenues increased to $16.9 million in Q2 of 2014, from $343,000 in Q2 of 2013. This increase is primarily related to the addition of Mandiant's incident response business in 2014.

Excluding professional services, our geographic mix in Q2 included approximately 68% of our revenues coming from US accounts, and 32% coming from international accounts, compared to 74% and 26% respectively in Q2 of 2013. The continuing increase in revenue contribution from international regions is validating the significant investments we have made in these new markets. Our product gross margins remained strong in Q2.

As a percentage of product revenues, our gross margins were 71% in Q2 of 2014, compared to product gross margins of 68% in Q2 of 2013. As a percentage of subscription and services revenues, our gross margins were 67% in Q2 of 2014, compared to 74% in Q2 of 2013. This decrease relates primarily to increased head count in our incident response organization, as we expand this capacity to respond to international breaches.

We also increased our capacity for our Managed Defense and Threat Analytics platform. As utilization at this new capacity grows, we expect our subscription and services gross margins to increase. One last factor to this decrease relates to a year-over-year expansion in our global support personnel, which totaled 178 individuals in Q2 of 2014, compared to 106 in Q2 of 2013.

Our total operating expenses increased to $141.9 million in Q2, from $58.2 million in Q2 of last year. While we continue to increase our investments in research and development, sales and marketing, and global infrastructure, our operating expenses as a percentage of revenue decreased from 175% in Q2 of last year to 150% in Q2 of this year.

In particular, our investment in sales and marketing as a percentage of revenues decreased from 109% in Q2 of 2013 to 80% in Q2 of 2014. This improved leverage is resulting from the continuing expansion of our revenues in our domestic and international markets, and the increasing productivity of our sales force as they move up the productivity ramp.

In terms of our financial condition, we exited the second quarter with approximately $465 million of cash and investments on hand. Our accounts receivable increased to $108 million at the end of Q2. Our aging and collections remained strong. This increase in receivables relates to higher billings in the quarter, as well as a higher percentage of these billings occurring near the end of the quarter. Our inventory levels remain stable, and we do not anticipate any issues with respect to excess or obsolescence in our stock.

Finally with respect to Q2, as you know, we have not reported pro forma combined financial results for the second quarter of 2013, so the financial statistics I have addressed in my comments only include FireEye stand-alone results for the 2013 quarter. However, the Mandiant combination is a key contributor to our growth, so I'd like to provide some commentary into the pro forma growth contributions of both businesses in the second quarter.

Specifically, total product and product subscription billings for FireEye and Mandiant each grew at a greater-than-65% rate in the second quarter. In addition, product and product subscription revenues for FireEye and Mandiant each grew at a greater-than-50% rate in the second quarter.

In terms of our guidance for the third quarter of 2014, there are two topics I would like to cover before providing our guidance ranges. First, in the last 18 months we have completed five acquisitions, the two most recent of Mandiant and nPulse being the largest. We've had sufficient time as combined operations to identify opportunities for cost synergies, and we have initiated a process in the third quarter to optimize our spending.

We expect to achieve these cost savings in Q3 and Q4 of this year, and we expect that they will relate primarily to personnel resources and facilities consolidations. We expect to incur one-time charges in the next two quarters related to these efforts, and these charges will primarily be comprised of severance cost and excess lease commitments. The guidance I'm about to provide for Q3 excludes the costs that will be incurred as a one-time charge.

In addition, near the end of the second quarter we made changes to our e-mail product that will allow us to recognize revenue for this product in period rather than a ratable basis. For all e-mail shipments prior to this change, those billings will continue to be amortized ratably over the life of the initial contract. We have been working with our project managers and our auditors for several quarters to implement this change, because it brings into alignment our accounting treatment of web, file, and e-mail sales. We believe this change provides better clarity into our results of operations

Because this change was implemented late in the second quarter, it did not have a significant impact on our Q2 reported results. Specifically, we exceeded our Q2 guidance, as well as the analyst consensus estimate for product revenues, total revenues, and EPS, before the impact of this change.

In terms of guidance for the third quarter of 2014, we expect our billings to be in the range of $150 million to $155 million. We expect our revenue to be in the range of $114 million to $117 million, which excludes approximately $1.7 million of revenue amortization related to the deferred revenue haircut from the Mandiant acquisition. We expect our Q3 gross margins to be in the range of 68% to 71% after the effect of the deferred revenue haircut.

For operating expenses as a percentage of revenue in Q3, we expect R&D spending to fall in the range of 41% to 44%, sales and marketing spending to fall into the range of 77% to 80%, and G&A spending to fall into the range of 18% to 21%.

Based upon our weighted average -- estimated weighted average shares outstanding of 144 million shares, we expect our loss per share in Q3 to fall within the range of $0.52 to $0.56 per share. For the fourth quarter of 2014, based on our estimated weighted average shares outstanding of 148 million shares, we expect our loss per share to fall within the range of $0.46 to $0.50 per share.

In terms of total-year guidance, we are raising the 2014 guidance that we previously provided, specifically the billings in 2014 will now be in the range of $560 million to $580 million, and revenue for the combined Company will be in the range of $423 million to $430 million.

Regarding the components of our revenues, we estimate that product revenue will comprise 40% to 45% of total revenues, subscription and support revenues will comprise 40% to 45% of total revenues, and professional services will comprise 15% to 20% of total revenues. We expect our gross margins for 2014 will be in the range of 69% to 72%. For operating expenses as a percentage of revenues in 2014, we expect R&D spending to fall within the range of 41% to 44%, sales and marketing spending to fall into the range of 76% to 79%, and G&A spending to fall in the range of 18% to 21%

Excluding the impact of tax benefits related to the Mandiant and nPulse acquisitions, we expect to record a tax provision of approximately $1.7 million to $2 million per quarter in the second half of 2014. Based upon our estimated weighted average shares outstanding at 142 million shares, we expect our loss per share in 2014 to fall within the range of $2.05 to $2.15 per share. That completes my prepared comments. I will return the call to Dave for some closing comments and Q&A.

Dave DeWalt - *FireEye Inc - Chairman, CEO*

All right, Mike. Thank you, and thank you all for your time this afternoon. I hope you can tell how excited we are regarding the future of FireEye, and our opportunity to transform the security industry. Like sales force and CRM, our work day in human resources, and service now on IT, we have the opportunity to transform the security industry with both disruptive technology and a new business model.

As the pace of attacks and the cost of breaches continues to escalate, I believe FireEye is entering a phase of sustained growth and leadership, supported by our competitive advantages in detection technology, threat intelligence, and global infrastructure.

No competitor can deliver the intelligence and security architecture to address advanced threats, as we've shown in our recent Maginot Line study. As investors in FireEye, I hope you'll read it. It's going to be an exciting journey. I look forward to keeping you updated. With that, I'll turn it back over to Kevin and Kate for some questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Rick Sherlund, Nomura.

Rick Sherlund - *Nomura Asset Management - Analyst*

Good quarter. First on John McGee, are you planning on any changes, restructuring and so forth of the sales organization? We've found historically that can be kind of disruptive. If you can address what your plans might be there?

Dave DeWalt - *FireEye Inc - Chairman, CEO*

Sure, Rick, absolutely, John's in the room here, as well, and some others. We're really excited to have John come aboard, number one. But we really have kind of a best of both worlds, frankly. We have Jeff Williams, who's done an amazing job helping to build this Company from sort of zero to $0.5 billion range here. He's taking over the big portion of the Americas operation, which as you know is 65% to 70% of our business. John's taking over global sales. John's had a track record of running and operating billion-dollar-plus businesses, so we're excited to have both of them.

But the answer to your question is no, we're not do anything restructuring in sales operations. We're tuning it a little bit. We're continuing to optimize the plays that Mandiant has and FireEye has. I still think we're in early innings of getting all the synergies from those two combination of companies.

But for the most part sales is doing great. We're scaling internationally. We have multi-vectors of sales we're doing, both inside sales, partner sales, service-led sales, and product sales. For the most part we feel pretty good about what we're doing. We're just trying to bring in some new leadership to help get us to the next level, and quite frankly, just augment what we've got. No major change there.

Rick Sherlund - *Nomura Asset Management - Analyst*

Okay, thanks on that. While I have you then, on the sales cycle, any comments in terms of with Mandiant, has it -- and the branding benefit you get from that and the publicity around Target and some of the others? Have you seen any material shortening of the sales cycle?

Dave DeWalt - *FireEye Inc - Chairman, CEO*

Yes, Rick, it's a great question. One of the things that Mike alluded to in his script was improving our cross-sell between FireEye's base and Mandiant's base, and Mandiant's stuff back to FireEye. We made some really good traction. We went from like 15 or so cross sales from Q4 to Q1 in our first quarter of operation, and now had triple that in the next quarter of operations.

We're seeing some good things. The number of companies that we've cross-sold to is picking up. Pretty optimistic about the second half, as we really get the products integrated, the service plays integrated. But it's still early day. We like what we're seeing. They are shortening the sales cycle, especially where the Infinite Responding-led model starts.

We've also seen some more success in leading with services as an engagement before we do a proof of concept, a proof of value of FireEye's product. Mandiant brings us something very unique there, where we can do things like strategic program assessments or vulnerability assessments in the account before we bring in a FireEye appliance. That helps the conversion rates. A number of synergies that are starting to get there. I think as time tells, we'll get even more. Good question, thank you.

Rick Sherlund - *Nomura Asset Management - Analyst*

Thank you.

Kate Patterson - *FireEye Inc - VP, IR*

Next question, please?

Operator

Rob Owens, Pacific Crest Securities.

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Rob Owens - *Pacific Crest Securities - Analyst*

Good afternoon. Could you talk a little bit about the change in your e-mail rev-rec, and potentially how that impacted guidance for the second half?

Michael Sheridan - *FireEye Inc - SVP, CFO*

Sure Rob, it's Mike. What we've done historically is we've recognized the hardware portion of our e-mail sales ratably over the contract period of the subscriptions that go along with it. The reason we've done that historically is because in the event of a non-renewal, the box would not continue to provide functionality.

What we changed is to the same model we have in our Web product, which is in the event of a non-renewal, there will still be value provided but it will decline rapidly over time in the event of a non-renewal. We felt that change -- and by making that change by the way, that caused us to be able to recognize our e-mail in period, just like we do with our Web and our file products. It's been our desire to do this for quite some time.

It's been a lot of work to get the product aligned with it, as well as making sure that on the accounting side everybody is aligned, and we achieved that this quarter -- as I mentioned, very late, so it's really more of a prospective change. You've seen the changes that I've made into our guidance. It doesn't affect billings of course, but it does affect the timing of revenue, and that's incorporated into the guidance that I provided.

Rob Owens - *Pacific Crest Securities - Analyst*

Great. Any sense of quantification as we look at Q3 or Q4 relative to that change? I think you mentioned this quarter it was nominal. You would've over-achieved on the high end, even without it?

Michael Sheridan - *FireEye Inc - SVP, CFO*

Yes. Historically we've guided e-mail as a contributor as a percentage of our billings. We won't be doing that going forward, because it was necessary in the past because of the ratable treatment. You should look to e-mail contribution in the same way that you've looked at it in the past with results -- with respect to ratable treatment. I would say that there really hasn't been a change to the kind of guidance we've provided on that in the past. But the contributors to the overall revenue guidance change includes some e-mail, includes some of the increase in billings that I also mentioned, and it's a combination of all of the above.

Rob Owens - *Pacific Crest Securities - Analyst*

Thanks, and Dave as you look at the market place, you mentioned you're doing a better job of cross-selling. Talk about new customer acquisition, because it seems like there's a lot of noise out there from competition. Are you seeing any elongation in sale cycles, or just how that's playing out? Thanks.

Dave DeWalt - *FireEye Inc - Chairman, CEO*

Yes Rob, good question. I think that's the heart of what we watch and monitor here. I look at three areas, as you described. One is what call a brand-new sale. We have very strong results across the board with that internationally with new customers, non-Global 2,000 Global 2,000. Felt pretty good with the number of new customers that we're chasing -- pretty high numbers. You saw the numbers we reported in the 200-plus range. That feels pretty good.

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The up-sell is getting going. I would give us early innings of that game that we've got to keep improving upon. We certainly did a lot better in Q2 than we did in Q1 when it came to cross-selling of FireEye-Mandiant technology, and even selling multiple products, as Mike mentioned, into FireEye cases in the FireEye customers. Then it's just the up-sell is the last one -- selling more product to the same customer. All those keep moving positively. The competition really hasn't had any impact that's of notice. Quite frankly, our win rates are extraordinarily high across the board.

We recognize we're not in all markets in all segments. But at the same time, whenever we've competed directly, we have a very high win rate -- near 100% win rates. We continue to separate ourselves, Rob, I think because the security threat is very complicated. Even when you do detect a threat, a la a Target case, it takes people and process to resolve these breaches. That's what I alluded to about the next-generation security platform If you don't have people, process, and product intertwined to a platform, it's very hard to solve customers problems.

I think in that regard, we're very unique in the market place. It's not just a product Company here. We have that architecture built worldwide. None of our competition has services models like we do. They don't have the threat intel that we do. They don't have the detection products that we do. When I look at that compared to where we're at with competition I feel good about it. It really comes down to sales execution, product reach. Can we get really good at that cross-selling model? I think we're seeing that, and hopefully in the second half you'll see a lot more. Good question.

Kate Patterson - *FireEye Inc - VP, IR*

Next question, please.

Operator

Matthew Niknam, Goldman Sachs.

Matthew Niknam - *Goldman Sachs - Analyst*

Hi, guys. Congrats on the quarter, and thanks for taking my question. Obviously the Company's added head count very aggressively in recent quarters. As you consider moving towards the next stage of growth, do you feel comfortable with what you've done putting in place from a head count perspective, and maybe put another way, how do you think about incremental expense growth from here, given the ramp we've seen to date? Thanks.

Dave DeWalt - *FireEye Inc - Chairman, CEO*

Okay Matthew, I'll start. Mike, feel free to add on. I alluded to a little bit this next phase of the Company, and I think it's important, Matt, to understand that. We had that Phase I, which is called the start-up Company, with [Shard] and the team here, and Kevin when he was at Mandiant -- very frugal stage, trying to get a product launched.

We then had a good period of time here in the next phase, which was all about high, high-end growth -- explosive growth, if you will. I see ourselves reaching another phase, where we continue that high-growth trajectory that we're on, but at the same time we'll really march more aggressively toward profitability, towards cost management.

Mike alluded to it. We're doing some optimization across the Company. We've hired several thousand people here over the last couple of years, and grown from hundreds to well over 2,000 people. We've acquired a few companies, and we want to make sure we got the synergies right, both from a revenue side and the cost side.

That's reflective in our guidance. We want to keep being mindful of that. I think it's important as we get to the next stage of the Company that we show leverage -- not just in sales and marketing, but across the Company. You're seeing that as we lowered our loss per share to $2.05 to $2.15 on our range. That's down quite substantially from the prior guidance. Hopefully that's a good direction for us. Mike, did you want to add on to that?

Michael Sheridan - *FireEye Inc - SVP, CFO*

Yes. I would add, Matt, the way to think about it I think is the strategy that we have focused upon globally to expand our global presence and infrastructure remains. We believe it's the right strategy. As you can see in some of our billings and revenue contribution, it's really a global success, and we think that's the right strategy to pursue. That said is we've had time to integrate the companies that we've brought together. Ultimately, we were very interested in finding out how we could run these companies on a combined basis more efficiently, and I think we're doing a lot of work successfully to identify those.

Strategy the same. You'll see absolute spending aligned with what you've seen in the past, but the growth -- because I think we'll successfully remove some of these costs -- will start to taper. What you'll see, if you break it down into our investments, I think in areas like R&D I mentioned a little bit about Managed Defense platform and the Threat Analytics platform. Those are areas we're investing in, and expanding head count to address those.

Other areas you can see in my guidance around sales and marketing. That leverage is now moving into the high 70s. Last year it was over 100% of spend as a percentage of revenue. Same thing with G&A. You're starting to see the G&A percentage start to move more towards our target model that we've talked about. Overall, I think these are the right things to do. As David mentioned, in this phase we're going to continue to focus on growth in investment; but really at the same time take a hard look and make sure that our spending is efficient and effective.

Matthew Niknam - *Goldman Sachs - Analyst*

Very helpful, thanks.

Operator

Daniel Ives, FBR Capital Markets.

Daniel Ives - *FBR Capital Markets - Analyst*

Thanks, guys. Tom, I'm curious in terms of not just sales cycles, but competition-wise, are you starting to see any changes out there, as more of your competitors are going after the same space -- almost copycat solutions? Are you seeing any changes out there in the field?

Dave DeWalt - *FireEye Inc - Chairman, CEO*

Daniel, this is Dave. I would tell you similar to I think what Rob was asking, Rob Owens was asking, we haven't. Sales cycles have been very consistent. The average sales price discounts have been consistent. We certainly see the news much like you do about competitors kind of copying FireEye's model here, and talking about sand boxes or virtual machines or some sort of improved detection. But the proof is when we compete head-on, and we feel we have a substantial gap.

It's important -- and I know you understand this -- putting virtual machines in line real-time, and analyzing real traffic at millions of objects per hour, is not something any competitor's been able to do. To do so with a virtual machine that has been written from the ground up that can camouflage from these attacks really is an extraordinary advantage that we have.

When you look at the competition, yes there's a lot of messaging out there. But when you look at the technology itself, and when customers look at it directly, we feel very confident the gap is wide when it comes to detection. As I said earlier, I think the competition is going to have to play a lot of catch-up in this next phase, in my opinion, because it is more than just detection. You have to respond to the threat, you have to be able to analyze that threat. You have to manage these threats and these breaches in different ways, and it takes more than a product to do it.

I believe that the people side and experts at Mandiant really come into play of this. The threat intel comes into play. Now that we're building these Managed Defense SOCs, or security operations centers around the world, it really gives us a very unique advantage against point-product companies selling a single solution in this market compared to a platform play like us.

It's going to take us a little bit of time to get all that rolled out and get that messaging there. I tried to call out some color of some of the deals we've won with very large Global 2,000 companies, as well as SMB companies. We're kind of in that inning two, as I mentioned. We feel like if we can keep going after that, our competitive gap will grow, not shrink. Good question.

Operator

Walter Pritchard, Citi.

Walter Pritchard - *Citigroup - Analyst*

Hi, how are you doing, Dave? A question for you, Dave, on the government side. You guys have done well in that market. I think your product is ahead of the pack in terms of certifications and so forth there. Can you talk about what you're seeing in terms of Q3 in the government, when spend is usually pretty robust?

Dave DeWalt - *FireEye Inc - Chairman, CEO*

Yes, Walter, it's that time of year, isn't it? It's Q3 and the end of the fiscal year for United States federal government, at least. I've always had a strategy, as you know from my McAfee days, to win the government and win the market. We've done a lot of the foundational work, I believe, here at FireEye to win a lot of government. I called out 150 military intelligence operations around the world, 50 different countries using our technology. Getting the base in place to really materially up-sell and cross-sell from that base.

This quarter again, with the US federal we're seeing a lot of opportunity. You've got to execute on it, clearly. But at the same time, we're much further along than we were even two quarters ago with our progress in that market, because Mandiant brought us a lot of synergy in that particular sector, as well as other governments around the world. We feel optimistic that we have the business there. The pipeline feels good. If all goes well, we'll have a really good government quarter, and hopefully a really good end of second half of the year. Good question.

Walter Pritchard - *Citigroup - Analyst*

Mike, one numbers question here. It looks like your product revenue was actually ahead of your product billings, which hasn't happened since we've been tracking the numbers here. You did talk about some changes to rev-rec coming, but could you talk about what drove that during the second quarter?

Michael Sheridan - *FireEye Inc - SVP, CFO*

I don't think anything that's really trended, Walter. I just think it's a timing issue between bringing two businesses together. If you look at it on a pro forma combined basis, that's one of the things that's going to fall out of it. There's not perfect alignment there, but you're right. Generally, the billings will out-pace the product revenues; but the variances is pretty small, and there's nothing in it that's implying any kind of trend.

Walter Pritchard - *Citigroup - Analyst*

So we should expect that product billings is generally in excess of product revenues, except for maybe seasonally weaker quarters?

Michael Sheridan - *FireEye Inc - SVP, CFO*

Right.

Walter Pritchard - *Citigroup - Analyst*

Okay, thank you.

Operator

Gray Powell, Wells Fargo Securities.

Gray Powell - *Wells Fargo Securities - Analyst*

Great, thanks for taking the question. I just have a few. If I look at your billings disclosures, a couple things jump out at me. First, pro forma for Mandiant, the absolute dollar billings growth in 2014, according to guidance, will be $190 million this year, versus the $163 million that you added in 2013. That's actually a pretty good acceleration.

The other thing that jumps out is the implied Q4 guidance at the mid-point shows 55% year-over-year growth, versus closer to 47% growth in the first nine months of the year. My question, or how much of the 2014 acceleration is due to cross-selling versus new products versus favorable warranty conditions? Then how confident are you in the implied ramp for Q4 2014. What's the main driver there? Thanks.

Dave DeWalt - *FireEye Inc - Chairman, CEO*

I'll take some of the color points, Mike, if you want to take some numbers in the second. When we look at the pipeline for the second half of the year, we're seeing a lot more cross-sell opportunities, as you sort of mentioned, in the Q3 and Q4 quarters. Sometimes timing in one quarter together is hard to predict, but when you look at the amount of pipeline build, we still have a very small percentage of FireEye and Mandiant overlap customers.

There's a lot of cross sell that we can do -- FireEye appliances and products sold into the Mandiant Managed Defense model; Infinite Responding by Mandiant leading into FireEye product; FireEye product cross-selling Endpoint product for Mandiant, and things like that. Each quarter we're getting a little stronger with the synergies as we kind of go throughout the year.

As we look into the second half, with enterprise spending you tend to see a lot more opportunity if you're us, as we worked during the first half of the year to build pipeline and close it in the second half of the year. For all the factors that I just described, that's why you're seeing an increase of that growth rate a bit, as you get into the first nine months versus the Q4 quarter; just because again, a lot of things get teed up. A lot of renewal opportunity. A lot of opportunity for us to close bigger transactions. We think the pipeline and outlook looks good there. Mike, do you want to add onto that?

Michael Sheridan - *FireEye Inc - SVP, CFO*

Just in terms of the guidance, one thing that we haven't done -- because we're not really running the business this way -- is we haven't guided the growth in 2014 for the FireEye business and Mandiant business separately. I know that there's ways of sort of breaking the numbers down, and I think that's healthy.

Overall, I think the way we're looking at the business, and Dave just articulated it, is we're running it as one business. As I mentioned in my comments, we are seeing a good increase in the number of accounts that are purchasing products across Mandiant, FireEye, nPulse, and so forth. That's a primary driver. I think in terms of confidence, certainly just the fact that we're guiding it, we believe that the road is there. We believe the pipeline is there. We think our sales force is making great progress ramping up. Yes, we're heading into the second half with an optimistic view.

Dave DeWalt - *FireEye Inc - Chairman, CEO*

Did you have one more, Gray?

Gray Powell - *Wells Fargo Securities - Analyst*

Got it. Thank you very much. I'm good, congrats.

Dave DeWalt - *FireEye Inc - Chairman, CEO*

Thank you.

Operator

Brent Thill, UBS.

Brent Thill - *UBS - Analyst*

Good afternoon. Dave, you mentioned the product evolution to over 20 new products. I know you love all your kids equally; but if you looked at the new solutions coming to market, which ones would you highlight that you're probably the most excited about, in terms of an immediate needle-mover? I had a quick follow-up for Mike.

Dave DeWalt - *FireEye Inc - Chairman, CEO*

Yes, Brent, absolutely great question, actually. We've got our product machine cranking our products now, but we've really got to get ourselves to selling multiple products in the initial deal, cross-selling those products more easily. We've worked very hard at trying to get the product in packaging. To answer your question, there's two or three what I call blades or feature areas to our main flagship product, which is our NX or our web product.

As you know, this is the product that's driven a lot of the FireEye model in the past. One is the IPS product. We feel very good about that product so far. The amount of falsing that the traditional products does can be dramatically reduced with our virtual machines. The amount of true positives that we discover are extraordinary with that combination.

It's really just a blade in our NX as a software update to the current hardware, at essentially 15% subscription of the hardware price. That one felt good, and at the end of Q2 we started to get some good sales there. I think that will start to pick up, and a chance to consolidate some spending that's already in motion with a lot of companies, and after.

The other blades that are in the NX platform are pretty exciting, too. One I mentioned, which is our advanced threat intelligence. We now have two subscriptions to our intelligent cloud -- one called DTI, or dynamic threat intelligence, which is FireEye intelligence. The second one now is advanced threat intelligence, which is essentially Mandiant threat intelligence. What it allows us to do, whenever we detect a threat in an architecture, we get a threat score, which is coming from FireEye and DTI; but we can add to it kind of a risk score.

The risk score is essentially adversary information, more information about what's called the tools and techniques and procedures of the adversary. It kind of helps us understand, is it the Chinese attacking you, is it the Russians attacking you, is it that Iranians attacking you -- not just as their alert, but what's the relevant portion of that intelligence; and we can do it at the point of alert real time with both intelligence engines.

The long and short of that is, we have a number of new blades to our flagship product. We've also added a MacOS capability. We can now have multiple guest images running real-time network -- not just a Windows platform but now the Apple platform, that's a first in the industry for virtual machines, especially running real time.

A number of kind of add-on things are pretty exciting, and then the Cloud stuff that we're doing, particularly this product called Threat Analytics Platform, kind of a next-generation SIM-type product. It's starting to get some good traction, we're excited about that. Still a little early days in the first half of the year, but I think the second half has a lot of pipeline.

Interesting technologies there to really bring SIM from the prem to the Cloud; and leveraging some of the technologies, like Amazon's web services to do it. A bunch of new products, pretty exciting. We've got to get them going. We've got to get them cross-selling, but that's part of the next chapter of the Company. Yes, good question.

Brent Thill - *UBS - Analyst*

Okay. Mike, just on billings, you had fairly strong upside in Q1. The upside relative to your high in the guide wasn't as large this quarter. Is there anything that we should sense in terms of how that weighted the quarter? Was it more back-end loaded that perhaps you maybe booked more the you billed, and we just don't see that? Any other anomalies to explain for that on the total billings?

Michael Sheridan - *FireEye Inc - SVP, CFO*

I think the biggest factor, Brent, is what I mentioned with respect to average contract length. As you know, we sell primarily one-year and three-year contracts. In recent quarters we've seen the trend of the average contract length moving up to 30, 31 months. In fact in Q2 of 2013, that was the average contract length that we were booking. In Q2 of this year, that came down to 27. As a result, obviously the billings for those out years wasn't as big of a contributor.

The reason it came down a little bit are twofold. One is that it's a normal fluctuation in the business. The second is we are working with our sales force to ensure that they are properly incentivized -- not just to achieve their quotas without your billings and bookings, but also to really focus on product penetration, market penetration, and first-year penetration. We've made some changes to get them focused on that. We're seeing some good results from it. That would be the biggest factor in terms of looking at that overall billings upward --

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Brent Thill - *UBS - Analyst*

Okay, thanks.

Dave DeWalt - *FireEye Inc - Chairman, CEO*

One more question, please.

Kate Patterson - *FireEye Inc - VP, IR*

We have time for one more.

Operator

Gregg Moskowitz, Cowen and Company.

Gregg Moskowitz - *Cowen and Company - Analyst*

Okay, thank you and good afternoon. Dave, you've hired a ton of feet on the street over the past year-plus. Wondering how you would characterize your sales productivity today, as well as what you think we'll see over the next six to 12 months? I had a follow-up for Mike, as well.

Dave DeWalt - *FireEye Inc - Chairman, CEO*

Yes, Gregg. We could always do better, that's for sure. That's the way I would describe it. It still feels early. We've gone from just a couple of products, as I mentioned, to quite a big suite of products. We've gone from a couple of countries we're selling to, to 60-plus countries. We've gone from largely selling in the Global 2,000 to now selling in the non- Global 2,000. It takes a little maturation for us to get the productivity really where we want it.

We're focused in on making the hiring that we've done already really ramp up. I think that we can get there in the second half of this year and beyond, but it takes a little time, and we're excited about the progress. But in the grand scheme of things, I still think we're early days in this whole play that FireEye's doing, particularly with Mandiant.

Especially think at Mandiant international, as well, another area for us to improve upon with productivity. Mike alluded to a lot of service investment we made in the international markets. They're just getting ramped up. You can't get these incident responders in a day, fully billable, and completely utilized. But the progress seems to be there, the pipeline seems to be there, and I think those investments will start to pay off, both in productivity as well as billings and revenue. You had another one?

Gregg Moskowitz - *Cowen and Company - Analyst*

Thanks, Dave. That's great, that's helpful. For Mike, and Dave actually may have partially answered this, but I just wanted to expand on this if I could. If you look at product and product subscription billings, both were quite strong in the quarter, although professional services billings were down slightly versus Q1. I'm wondering if you could speak to the dynamic that you saw in the services side this quarter, and if there was anything that you would call out, either in the US or internationally? Thanks.

Michael Sheridan - *FireEye Inc - SVP, CFO*

I think a couple of things. On the international front, as Dave mentioned, we are just now getting started with those investments. I think overall the services businesses is performing well. It tends to be a bit more tied to breach activity than a sales force out creating pipeline.

It's a part of our business that will be a little more dependent on what might be happening in the market. For example, if you have a major breach, that might drive a little more in one quarter versus another quarter. Overall, we think the business is strong, and as we start to pick up utilization in the new capacity, we think that the growth in the margins in that part of our business are going to stay in that 15% to 20% of our total revenue contribution.

Gregg Moskowitz - *Cowen and Company - Analyst*

Great, thank you.

Dave DeWalt - *FireEye Inc - Chairman, CEO*

Good, okay. I'll just wrap up, Kevin, if it's all right. This is Dave DeWalt. I just want to again say to all the investors thank you. To all the employees on the line, really proud of you all for your accomplishments in Q2, not only beating the numbers again and now having a chance to raise our guidance for the second half of the year. Hopefully we'll get a chance to see everybody soon, and we're looking forward to that this summer at the investor conferences and things. With that, we'll end the call. Thank you very much. Have a good day.

Operator

Ladies and gentlemen, this does conclude today's conference call. If you were in queue to ask a question, we have taken your names down and will do call-backs. You may all disconnect and have a wonderful day.
