

THOMSON REUTERS

EDITED TRANSCRIPT

Q4 2018 SecureWorks Corp Earnings Call

EVENT DATE/TIME: MARCH 28, 2018 / 12:00PM GMT



CORPORATE PARTICIPANTS

Michael R. Cote *Secureworks Corp. - CEO & President*
R. Wayne Jackson *Secureworks Corp. - CFO*
Teri L. Miller *Secureworks Corp. - VP & CAO*

CONFERENCE CALL PARTICIPANTS

Alexander Henderson *Needham & Company, LLC, Research Division - Senior Analyst*
Fatima Aslam Boolani *UBS Investment Bank, Research Division - Associate Director and Equity Research Associate*
Technology-Software
Jonathan Frank Ho *William Blair & Company L.L.C., Research Division - Technology Analyst*
Matthew John Swanson *RBC Capital Markets, LLC, Research Division - Senior Associate*
Melissa A. Franchi *Morgan Stanley, Research Division - VP*
Saket Kalia *Barclays Bank PLC, Research Division - Senior Analyst*
Sterling Auty *JP Morgan Chase & Co, Research Division - Senior Analyst*

PRESENTATION

Operator

Good morning, and welcome to the Secureworks Fourth Quarter and Full Year Fiscal 2018 Financial Results Conference Call. (Operator Instructions) We are broadcasting this call live on the Secureworks' Investor Relations website. (Operator Instructions) Now I will turn the call over to Teri Miller, VP and Chief Accounting Officer. You may begin.

Teri L. Miller *Secureworks Corp. - VP & CAO*

Good morning, everyone, and thank you for joining us today to review Secureworks' financial results for the fourth quarter and full year of fiscal 2018. This call is being recorded. This call is also being broadcast live over the Internet and can be accessed on the Investor Relations section of Secureworks' website at investors.secureworks.com. The webcast will be archived at the same location for 1 year.

This morning, Secureworks issued a press release announcing results for its fiscal year ended February 2, 2018. You can access this press release on the Investor Relations section of the Secureworks website.

During this call, management will make forward-looking statements within the meaning of the private Securities Litigation Reform Act of 1995. These forward-looking statements include, but are not limited to, guidance with respect to GAAP and non-GAAP revenue and net loss per share as well as adjusted earnings before interest, taxes, depreciation and amortization. Our forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those anticipated by these statements. You can find a description of these risks and uncertainties in this morning's earnings press release and in the company's annual report on Form 10-K for the year ended February 2, 2018, which will be available later today on our Investor Relations website and on the Securities and Exchange Commission's website.

All forward-looking statements made on this call are based on assumptions that we believe to be reasonable as of this date, March 28, 2018. We undertake no obligation to update our forward-looking statements after this call as a result of new information or future events.

Some of the financial measures we use on this call are expressed on a non-GAAP basis. These non-GAAP measures exclude stock-based compensation, the impact of purchase accounting, amortization of intangibles and the related tax effect of these items and impacts from the Tax Cuts and Jobs Act of 2017. We have provided reconciliations of the non-GAAP financial measures to GAAP financial measures in today's earnings press release available on our website. Non-GAAP measures are not intended to be considered in isolation from, a substitute for, or superior to our GAAP results, and we encourage you to consider all measures when analyzing Secureworks' performance.

Also, as a reminder, all financial information discussed is non-GAAP and growth rates are compared to the prior year period unless otherwise stated. Please recall that fiscal 2017 had 53 weeks of operation, with the fourth quarter having the extra week.



MARCH 28, 2018 / 12:00PM GMT, Q4 2018 SecureWorks Corp Earnings Call

With us on today's call are Michael Cote, President and Chief Executive Officer of Secureworks; and Wayne Jackson, Chief Financial Officer. Following the prepared remarks, we will take your questions. (Operator Instructions) Thank you for your cooperation on this.

Now I'd like to turn the call over to Mr. Cote.

Michael R. Cote Secureworks Corp. - CEO & President

Thank you, Teri, and thank you, everyone, for joining us this morning for our fourth quarter 2018 earnings call.

I am pleased to report that from a revenue and sales perspective, Q4 was the best in our history and exceeded our expectations. Revenue in the fourth quarter was \$121 million, up 10%. Our monthly recurring revenue grew 12% year-over-year and \$1.9 million sequentially to \$35.3 million, our largest sequential dollar increase in MRR in 10 quarters. This is a direct result of the hard work and determination of all of our team members, and I want to take this opportunity to thank each of them.

In the fourth quarter, we saw strong demand in all geographies and all industries. In the quarter, we closed 16 contracts greater than \$1 million, which represents a 45% sequential increase in the number of deals in this group. The total value of contracts in this group increased 58% sequentially, demonstrating our progress with larger, more complex security programs in both North America and internationally. In fact, our international momentum accelerated this quarter as our sales execution continued to improve and demand remains strong. In EMEA, sales grew 30% for the full year and 60% in the fourth quarter, while APJ grew 58% for the full year.

I'm excited Geoff Haydon has joined our Secureworks team as Chief Revenue Officer. Geoff's many years of successfully leading large sales organizations and working in the global security industry as well as the wealth of knowledge he has gained from his operating and general manager roles are tremendous addition.

Geoff has been with us about 2 months and has hit the ground running. He recently had the opportunity to lead our annual sales kickoff meeting, and his focus is on the following areas: first, people, progressing, elevating and expanding our sales team in markets around the globe; second, productivity, increasing the efficiency of existing team members and accelerating the on-boarding of new team members; third, coverage, optimizing our coverage model; and fourth, message and methodology, defining and executing sales plays that are repeatable and drive growth.

Although I am pleased with our progress in the fourth quarter, one quarter does not make a trend. Our client count remained at 4,400. While we increased our average revenue per client by 11% in Q4 with our success in the enterprise space, we must expand the broader base as well. Q4 sales results were good, but we must continue to focus on increasing productivity across the entire team on a consistent basis.

While there's still opportunity for improved execution, based on Q4 results and our sales pipeline, I am cautiously optimistic as we start fiscal 2019. We made some hard decisions in Q4 to realign resource levels in certain areas, which will allow for incremental investment in the business this year.

We have an experienced executive leadership team in place, talent across the entire organization and the industry-recognized security solutions required to continue to accelerate our growth.

One of the hallmarks of our company is our passion and expertise in protecting our clients. We strive to provide excellence, and we consistently seek to raise the bar by delivering industry-leading solutions that protect our clients in today's digitally connected world.

We believe that our commitment to excellence has led us to be recognized as an industry leader. Secureworks has once again positioned in the Leaders quadrant in Gartner's February 2018 Magic Quadrant for Managed Security Services, Worldwide, making this the 10th consecutive time the company has been recognized as a leader in this report [1...reference].

We know these accolades must be earned each and every day, one client at a time. In spending time with our clients, one thing is clear: the security landscape is changing faster than ever. We welcome and embrace this change as we see an opportunity to capitalize on our



strengths as the market transforms.

A great example of our ability to seize opportunity in this changing market is evident in one of the deals we closed in the fourth quarter. We signed a 3-year multimillion dollar contract with a global packaged food producer that has an aggressive digital transformation program underway. The solution set for this client encompasses: prevention and detection solutions, which leverage our years of cyber attack data, thousands of threat models and analytic capability, all powered by the Counter Threat Platform; we layered in our managed detection and response solution, which validates the threat real-time and then remediates the threat accordingly; next, we bring predictive capability of our Threat Intelligence solution; and finally, we are bringing our security architecture and design solution for a complete, secure transition to the cloud.

Of note, as we continue to expand our playbooks, all of our clients will see a marked reduction in the complexity of repeated tasks and an increase in the speed of the response to threat events. We were chosen in this competitive process because; one, our ability to develop a comprehensive security program unique to this client's needs; two, speed, they needed the solutions up and running quickly, while providing the ability to leverage data and analytics to tune solutions as we progress together; and third, our data-driven innovation and our agility to take the transformational journey with them.

Secureworks is uniquely positioned to help clients with on-premise cloud-based and hybrid environments in a connected and comprehensive way. In a nutshell, the depth of our portfolio, along with the full capability of our organization to quickly develop, deliver and continually transform with the clients' needs, ultimately, was the winning formula.

At Secureworks, we are uniquely positioned in the industry. Our solutions are based on years of cyber attack data and machine learning-based solutions that are the foundation of our Counter Threat Platform. We also recognize that velocity is key in our industry. Given the quickening pace of change in cybersecurity, we have dedicated a portion of our research and development spend to developing a new solutions framework that will allow for the rapid creation of high-value security applications, leveraging machine learning across diverse data sources. The applications will leverage our own proprietary technology and the effect of a community of trusted partners to rapidly develop and iterate.

This new design will also meet the growing needs for greater control over data access, including where data resides.

Our goal every day is to protect our clients, and we remain committed to bringing the best security solutions to our clients and leveraging emerging trends to drive growth. I will now turn it over to Wayne to talk about our performance in the fourth quarter and full results in more details. Wayne.

R. Wayne Jackson *Secureworks Corp.* - CFO

Thanks, Mike, and good morning, everyone. In the fourth quarter, revenue was \$120.8 million, a 9.6% increase when normalized for the extra week in 2017. We exited the quarter with monthly recurring revenue, or MRR, of \$35.3 million, an increase of 11.7% and a 5.7% increase sequentially.

Our average annual subscription revenue per client was \$96,000 this quarter, a 10.7% increase over the prior year and a 5.8% increase sequentially. As Mike noted, sales results for contracts greater than \$1 million were up 58% sequentially as we continue to reap the benefits of our sales investments in the enterprise space as well as in our international markets.

A couple of other revenue items of specific note. Revenue outside the U.S. grew to 17.7% of total revenue for the quarter, up from 14.7% last year, primarily on consistently strong growth in both EMEA and APJ. In addition, we had strong demand for consulting services as SRC revenue increased to 22.6% of total revenue for the fourth quarter.

For full fiscal 2018, subscription revenue was 78.2% of total revenue with consulting revenue representing 21.8% of total revenue. We believe the 80-20 historical mix remains a reasonable estimate of revenue mix for fiscal 2019.

Revenue retention in the period was 96% versus 97% in the third quarter. As a reminder, revenue retention measures how well we have



maintained revenue for clients we had on the first day of the year. Recall that this metric applies only to active clients and excludes backlog. Higher service churn during the first half of fiscal 2018 was a challenge to overcome as we move through the year.

Our fourth quarter gross margin was 52.8%, compared to 55.8% last year and 55.7% in the prior quarter. In Q4, severance costs negatively impacted gross margin by approximately 100 basis points. Incentive compensation was higher by approximately 50 basis points due to the better MRR performance in the fourth quarter. Also, the overall shift in revenue mix of SRC and associated delivery cost negatively impacted margins by approximately 150 basis points.

Moving down the income statement, our fourth quarter operating expenses totaled \$78.8 million, compared to \$68.7 million last year. In Q4, severance costs aggregated \$2.7 million across the operating expense category, primarily in research and development and G&A.

Research and development expenses increased to 17.1% of revenue in the quarter, up from 15.5% last year as we continued to invest in innovative technologies to meet our clients' evolving needs. We will continue to make incremental R&D investments in fiscal 2019 to further advance our orchestration and cloud offerings as well as for the new applications framework Mike mentioned.

Sales and marketing expense this quarter were approximately 32.3% of revenue, up from 27.6% last year as we invested in our sales capabilities. With better sales performance in the fourth quarter, commission expense drove higher sales expense as a percentage of revenue.

General and administrative expenses totaled 15.9% of revenue, compared to 14.5% last year, primarily as a result of increased bonus expense as well as the severance costs mentioned above.

The additional incentive compensation expense and severance charges increased our adjusted EBITDA loss to \$11.4 million or 9.4% of revenue for the quarter versus guidance of \$7 million to \$8 million. Our net loss for the quarter widened to \$9.9 million from \$1.6 million last year, primarily due to increased sales investments and the other expenses I've just highlighted. Net loss per share was \$0.12, including a foreign exchange impact of \$0.01.

I will now highlight a few items related to the full fiscal 2018, all on a non-GAAP basis. Total revenue was \$468.5 million, an increase of 8.9% compared to fiscal 2017. Full year non-GAAP revenue growth when normalized for the extra week was 11.2%.

Gross margin was 54.7%, compared with the gross margin of 53.9% last year. Including the items that negatively impacted margins in the fourth quarter of 2018 that I mentioned earlier, margins expanded 80 basis points, primarily due to leverage in our subscription-based solutions.

Our net operating loss was \$39.9 million, compared with a net operating loss of \$26.1 million in the prior year. This increase was driven by sales and R&D investments as we position for growth. Our adjusted EBITDA loss for the year was \$26.5 million versus a forecast of \$22 million to \$23 million. Net loss per share was \$0.34 for the year, including a negative \$0.02 per share of foreign exchange impact.

Moving on to cash flow and balance sheet items. Operating cash flow was \$4 million in the fourth quarter and \$0.8 million for fiscal 2018. In fiscal 2017, we had a use of cash of \$6.8 million. We invested \$2.1 million in the fourth quarter in capital expenditures to support our growth, bringing year-to-date CapEx to \$13.8 million.

Turning to liquidity. We finished the year with cash of \$101.5 million with no debt. We also have an untapped \$30 million credit facility, which was recently extended for an additional year on similar terms. Our net accounts receivable totaled \$157.8 million at the end of the quarter. Accounts receivable is higher due to seasonality associated with annual contract billings as well as the impact of revenue growth.

During the fourth quarter, we recorded a onetime tax benefit of \$0.34 per share in our GAAP results due to the impacts of the Tax Cuts and Jobs Act of 2017. The impact was primarily related to the remeasurement of our deferred tax liabilities. The implementation of the new tax law also had an impact on our fourth quarter effective tax rate as we had 1 month in the quarter at the new lower federal rate.



Also of note, our balance sheet has a tax receivable from Dell of approximately \$21 million, which we expect to collect during the second half of fiscal 2019.

Now for FY '19 guidance, which reflects the impact of ASC 606 and its related statements, which Secureworks adopted for fiscal year ending February 1, 2019, using the full retrospective option.

To assist with assessing this impact, we have posted a supplemental schedule detailing the quarterly impact for fiscal 2017 and 2018 on the Investor Relations section of the SecureWorks website. As indicated in the bridge summary included on our website, since most of our subscription revenues have always recognized over the life of the underlying contract, there was an immaterial impact on revenue of adopting the new standard. However, with the application of ASC 606, we will have a lower expense due to the requirement to defer and amortize client acquisition costs, including sales commissions and certain installation costs.

As you will see in the schedules, the impact of adoption on revenue in fiscal 2018 is about \$25,000, while operating loss is approximately \$12.5 million lower under 606.

For the first quarter of fiscal 2019, we expect both GAAP and non-GAAP revenues to be in the range of \$122 million to \$123 million, and we expect non-GAAP net loss per share to be in the range of \$0.06 to \$0.07 based on approximately \$81.0 million weighted average shares outstanding.

For fiscal 2019, we expect both GAAP and non-GAAP revenues to be in the range of \$512 million to \$516 million. We expect our non-GAAP net loss per share to be in the range of \$0.16 to \$0.20 per share, assuming a 26% effective tax rate and 81.0 million weighted average shares outstanding. We expect our adjusted EBITDA loss to be in the range of \$4 million to \$8 million. Also, for fiscal 2019, we expect GAAP net loss per share to be in the range of \$0.58 to \$0.62.

As I mentioned earlier, the impact of adopting ASC 606 is inconsequential to revenue, so whether you're comparing our guidance to fiscal 2018 on a 605 or a 606 basis, growth rates for the first quarter and the full year are the same.

The impact of the new standard does reduce expenses and our losses for the year. Our guidance range for non-GAAP net loss per share of \$0.16 to \$0.20 includes a benefit of \$0.06 to \$0.07 per share related to the expense reduction following the adoption of the new standard.

We expect our MRR to be in the range of \$38 million to \$39 million at the end of the fourth quarter of fiscal 2019. In addition, we expect our total CapEx will be approximately \$16 million to \$17 million for the full year. I will now return the call to Mike.

Michael R. Cote *Secureworks Corp. - CEO & President*

Thanks, Wayne. This quarter's positive performance shows we are making headway on our plans to accelerate our growth trajectory. Our clients trust us. It is foundational to all we do, and we fight to earn their trust and confidence every day.

We have a strong executive leadership team in place, positive momentum, and I am eager to execute against our fiscal 2019 plans. I look forward to providing further details on our progress next quarter.

Before I turn it over to the operator for questions, I want to again express my gratitude for the hard work and dedication of our team members that they put in every day to keep our clients safe in a digitally connected world. I would also like to thank our clients for allowing Secureworks to serve as their trusted cybersecurity partner, and our other stakeholders for their continued support.

Operator, if you'll now open the line for questions please.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We'll take the first question from Sterling Auty from JPMorgan.

Sterling Auty JP Morgan Chase & Co, Research Division - Senior Analyst

I wanted to start with if you could help us with maybe giving some additional color around some of the larger deals in the quarter, meaning, what kind of common characteristics are you seeing in terms of what they're looking to solve, deployment model and geography, that would be great.

Michael R. Cote Secureworks Corp. - CEO & President

Thanks for the question. So I don't have the specific data on the 16 contracts that we referred to that were all over \$1 million in annual contract value. They were pretty well geographically distributed between the United States and Europe, for the most part. They were across a group of different industries, so it wasn't as if it was any specific industry. The solutions would be similar to the ones that I noted in my prepared remarks, where they've looked for us to help do prevention and detection solutions as well as I have called it an industry term of managed detection and response where they're really asking us from a detection perspective to detect, validate and remediate the problem. Most of the contracts were multiyear engagements for the most part. And I think -- is there anything you'd add, Wayne?

R. Wayne Jackson Secureworks Corp. - CFO

No. I would -- this is Wayne, Sterling. So the client that Mike walked you through is a very large new contract for us. And the other 16 contracts is really a subset of those same services broken out differently for different clients.

Michael R. Cote Secureworks Corp. - CEO & President

I guess, the only other thing I'd add for you, Sterling, is that the sales cycles on 16 contracts probably range from a long of a year to as short as probably 3 months.

Sterling Auty JP Morgan Chase & Co, Research Division - Senior Analyst

Okay, great. And then one follow-up would be as you're heading into the new fiscal year, you have a new Chief Revenue Officer, how would you kind of characterize the status of the sales force and go-to-market function in total? Are all the pieces in place and changes are done? Or is there still some final work to be done in terms of moving parts?

Michael R. Cote Secureworks Corp. - CEO & President

So this is Mike, Sterling. I would say that the pieces are in place. And we've made a lot of progress in the last 12 months. Particularly, we closed Q4 under the leadership of our existing sales organization. I sort of mentioned the individuals in Europe and the U.S. And the 2 gentlemen in the U.S. and the one in Europe that were leading us globally, they're all here. Geoff has added a couple of senior leaders who actually start early next week, I believe. And I think the hope is and the plan is continued execution and continued increase of our productivity on a go-forward basis. And that we can -- as I mentioned, we have one dot, I'm hoping to connect incremental dots over time in the things that Geoff is focused on, which is the people, productivity, coverage and then consistent methodology and messaging.

Operator

Our next question is from Melissa Franchi from Morgan Stanley.

Melissa A. Franchi Morgan Stanley, Research Division - VP

Mike, you noted that the customer base was relatively flat, so I'm just wondering what you think is the biggest limitation for this number or what would get the number to move higher. And then should we expect that we could see a return to growth in the customer base just given the changes that you've outlined with the new Chief Revenue Officer?

Michael R. Cote Secureworks Corp. - CEO & President

So, Melissa, thanks for the question. Let me try and answer that in a couple of different ways. We don't operate the company based upon numbers of customers. It's based upon annual contract value or ACV is what we're really driving for. Our investments have been much larger over the last few years in the enterprise space, so the reason why we have an increase in the average revenue per client of 11% this quarter. We do want and it is important to have diversity of client base from a geography and a size perspective and are continuing to



invest in the lower end of the market, if you will, both from a size and maturity perspective. I would say small- to-medium-sized businesses market is important, but we're segmenting that slightly differently based upon the needs in those markets, and some of our larger clients may also fall into that space. So we do want to -- as I mentioned in my prepared remarks, we do want to increase the numbers of client. We came into the last few years with a much larger and still have a larger of our client base, a larger percentage is in the small- to medium-sized business. And we've got a larger investment from a sales organization go-to-market perspective in the enterprise space. So I would expect us to continue to see and focus on increasing our average revenue per client, first, and -- but continuing to focus on increasing the number of clients. Does that answer your question, Melissa?

Melissa A. Franchi Morgan Stanley, Research Division - VP

Yes, it does. And I guess, just following up to the comment on the average revenue per client up 11%. Can you maybe just add a little bit more color on what's driving that up-sell? Is it the enterprises are adopting MSS for a greater portion of their security architecture or are you starting to see enterprises purchase additional solutions like the advanced endpoint detection?

Michael R. Cote Secureworks Corp. - CEO & President

The answer to the question is yes. Meaning, that I would start with they're buying more solutions from us and there is more -- we're having more success in the enterprise space. Part of that may be the enterprise market is more interested in looking for solutions. I think there is in the market a change that's occurring. And the Equifax breach, quite frankly, I think helped drive some of this in North America from an enterprise space. And they're looking to become more -- they all -- all clients are looking and all of the industry become more effective around managing their risk and ensuring that the spend that they have is reducing risk. And our broad capability across the various aspects we can help them in has become -- we've seen -- we saw a lot of receptivity to it in the fourth quarter. I will also add that as we started about a year ago on a path to improve our execution from a sales perspective, including in North America, that we did make tremendous progress on that. I am pleased, but not satisfied, so we've made progress but we still have room to continue to improve as well on execution.

Operator

The next question is from Fatima Boolani from UBS.

**Fatima Aslam Boolani UBS Investment Bank, Research Division - Associate Director and Equity Research Associate
Technology-Software**

Mike, I wanted to drill in on the revenue retention rate that's sort of been hovering around in the mid-90s. And I'm curious, what sort of programmatic things you need to do to bring that back up to sort of the 100% levels? And then a follow-up.

Michael R. Cote Secureworks Corp. - CEO & President

So Fatima, thank you for the question. And Wayne, you can jump in here and help me if you'd like. I would -- we clearly are driven for north of 100% as a goal. The way the calculation works, just to remind you, is we take the beginning of the year recurring revenue from the people that our clients at that point in time that have been installed. So coming off of that base, if we start the year in a negative situation as we did this year, it's really hard to turn it around towards the latter part of the year, which I think is part of the impact that we had this year. I think the other part of the impact that we had towards the end of the year was we have to turn the sales into installed revenue in order to get the rate -- the client revenue retention rate to go back up. So I am cautiously optimistic for fiscal 2019 with the Q4 sales results we had and with the increased focus that we're going to have this year from a compensation perspective with our sales force on, not just sales, but renewing existing clients. Anything you'd add, Wayne?

R. Wayne Jackson Secureworks Corp. - CFO

Yes, so a couple. There are 2 moving parts here. One is cross-sells to existing clients, and we've talked about that over the last several quarters and we talked about our sales -- investments in sales groups. So that's a big focus for us. But then also, the retention, the renewal rate within that client base as well. And as we migrated to the enterprise space -- and keep in mind, enterprise clients, the average size of that contract is about 10x the size of an SMB client. So it's important not only to cross-sell into it, but to renew the contracts we have for the solutions we have in place at the enterprise space.

Fatima Aslam Boolani *UBS Investment Bank, Research Division - Associate Director and Equity Research Associate Technology-Software*

Fair enough. And just around the hiring of your new Chief Revenue Officer, nice to see that transition complete. With his background in RSA and on the EMC side of the house, can you give us an update on what your distribution relationship with Dell is? I know that was work in progress. So I'm curious as to the level of distribution horsepower or leverage you've seen from the Dell sales force with your solution. And that's it for me.

Michael R. Cote *Secureworks Corp. - CEO & President*

So thank you for the question, Fatima. I'd answer that to say that fiscal year 2018, we saw increased productivity and increased business with the Dell EMC sales organization. And the Dell EMC organization, overall, is part of the benefits being part -- being connected with the Dell Technologies. In this upcoming calendar year, there has been a change in that the quota carriers across the Dell organization are getting quota credit, not just a referral spiff, for anything that they sell for Secureworks. So we are excited and cautiously optimistic that there will be a continued uptick of sales opportunities, both jointly and referrals from the Dell Technologies sales force and, clearly, Geoff Haydon's relationship with the EMC sellers and in the RSA organization should be a positive in that.

Operator

Your next question is from Alex Henderson from Needham.

Alexander Henderson *Needham & Company, LLC, Research Division - Senior Analyst*

I think you guys have always talked about your platform as highly leverageable. And I was hoping you could just step through some of the line items and talk a little bit about where you think you have leverage and where you think you need to invest ahead of that leverage between gross margin, R&D, G&A and sales and marketing. It sounds like the platform ought to give you automation leverage on gross margins and it sounds like you've got spending increases in R&D, but maybe leverage in G&A. The one that I have a harder time getting around is the sales and marketing. Do you need to accelerate spending on sales and marketing to push to the top line growth, to expand geographically? Or would that be an area that you think you might be able to get some leverage on?

R. Wayne Jackson *Secureworks Corp. - CFO*

Okay. So Alex, this is Wayne. Let me start with leveraging on the platform, the CTP and within COGS. We have invested really starting several years ago that we've talked about during the last 1.5 years, we invested in technologies that make the Counter Threat Platform more efficient and more effective, of course, and we are seeing those leverages. Our gross margin increased, year-over-year, 80 basis points. And we talked about in spite of and including the fourth quarter charges that we have. So the leverage helped cover those incremental costs. So, a, we have leverage. We will continue to invest and it's very important for us to invest in the CTP for additional leverage going forward. Again, in both efficiency, but effectiveness because our clients focus on effectiveness, we focus on efficiency. As well as -- and then I'll get to R&D. So we're going to focus on -- we're going to continue to invest in the CTP, but then we're going to invest incrementally a little bit more in fiscal '19, as we talked about in the prepared remarks, in the platform that Mike discussed in his prepared remarks. So both of those, we're going to continue to invest and expect leverage going forward. Sales and marketing, invested heavily from, I'd call it, a step function in fiscal '18. We will continue to invest at the level we were at last year for sales and marketing. We will expect sales to increase and begin to reap those investments. So we think that the level is the right level. Now what you'll see as '19 rolls out, the impact of ASC 606. ASC 606, the dollars some of those will be capitalized so you won't see the same amount in the P&L. But the cash investments, sales and marketing, will be the same. And yes, we expect leverage in that going forward.

Michael R. Cote *Secureworks Corp. - CEO & President*

In sales and marketing, one of the, this is Mike, Alex, to add, as I mentioned, Geoff is working on productivity and having us to be able to be pushing so that Secureworks is in a position to have increased efficiency across our existing sales team, as we saw in Q4, but on a consistent and ongoing basis and growing increased effectiveness into fiscal year '19. So I think Wayne addressed each of the line items of your question, but if I sort of summarized it, sales and marketing productivity should go up, and you should not expect us to see it continue to increase. I would say, we'll be in the 30%-ish range of revenue. And there should be leverage on the G&A, and the R&D line will have leverage on it other than the investments we're making in kind of the new platform we're looking at, a new analytical type work we're doing.

Operator

Your next question is from Jonathan Ho from William Blair.

Jonathan Frank Ho William Blair & Company L.L.C., Research Division - Technology Analyst

I just wanted to first ask about the applications framework. And yes, maybe can you give us a sense of what that can add from an incremental contribution standpoint as well as how that maybe expands your opportunity set with your existing customer base?

Michael R. Cote Secureworks Corp. - CEO & President

Jonathan, this is Mike. Thanks very much for the question. Let me try and give you some insight. I will -- first of all, I don't expect a lot of addition or opportunity in this fiscal year. We are continuing to invest in our Counter Threat Platform because it's an extremely important part of what we're doing and where we're heading. We -- as the industry change -- is changing, as we've talked about on the last couple of calls, we have realized that the intellectual property that Secureworks has, the historical attack data, the algorithms, the analytics, the machine learning, we would like to be in a position where we can share that data across our clients and for anyone in the community that would like to participate with that while allowing the data to reside in any location. And we started about a year ago down a process and beginning to experiment with and prototype this. We're putting a little more effort and energy into it and have some alpha clients, I'll say, in the next 90 days that are going to be up and running on it. And we would hope to be in a position, as the year progresses, that it could have an impact on us in fiscal '20 or somewhere around in that time frame.

Jonathan Frank Ho William Blair & Company L.L.C., Research Division - Technology Analyst

Got it. And then just in terms of a follow up. We saw the strong international growth this year. How should we be thinking about the growth opportunity outside of the U.S.? And would you expect that to be significantly faster than the growth rate inside the U.S.?

Michael R. Cote Secureworks Corp. - CEO & President

So this is Mike again, Jonathan. Thanks. The base outside the U.S. is a smaller base. So from a percentage growth perspective, I would expect the growth rates, both in APJ and Europe, to exceed our North American growth rates. As I've mentioned, we have our leadership team and our sales general managers and leaders in those markets who have been in place for a longer period of time and are executing very well. And we're -- we are planning and optimistic that they will continue to have that execution level, and therefore, the growth rate as a percent outside of North America, I think, would exceed our North American growth rates. Now having said that, we are seeing improved productivity in North America and it's a focus area for Geoff. And I think we will see North America reaccelerate or continue to accelerate as we have in the fourth quarter.

Operator

Your next question is from Saket Kalia from Barclays Capital.

Saket Kalia Barclays Bank PLC, Research Division - Senior Analyst

First, maybe for you, Wayne. You gave some of the margin impacts of the severance starting the quarter. I think you said it was about 100 bps of impact in gross margins. Can you just remind us roughly how big the restructuring was in the quarter and what the total, I'll call it, onetime costs were?

R. Wayne Jackson Secureworks Corp. - CFO

Sure, Saket. So total restructuring or the WFR was rounded \$4 million -- \$3.7 million, broken out between COGS and OpEx.

Saket Kalia Barclays Bank PLC, Research Division - Senior Analyst

Got it, that's helpful. And then maybe for you, Mike. As you look at those 16 deals with over \$1 million in ACV, the question is how are those customers handling security internally versus co-sourcing with you? I guess, are these customers that don't have large security teams and therefore are maybe trying to mature their security organization? Or are they sizable teams already that were looking to have a partner? Does that make sense?



Michael R. Cote *Secureworks Corp. - CEO & President*

It does. I mean, so in no cases of those 16 contracts are we their only security solution, meaning, that they do not have an internal security group. When you say large, some of them have a large internal security organization and some of them it depends on how you -- large is a relative term. And some of them have, I'll say, a fair size internal security organization. Most -- all of them are going through the digital transformation and a change and looking for us to help them and help ensure they can deploy their resources in the appropriate manner to ensure the best solutions possible. The -- we would look -- let me try and add a little bit to this, we would look at sort of smaller clients or smaller opportunities or less sophisticated organizations to look at us and say, "Do it for me." In the larger organizations it's, "Partner with me" or in a complex session, and I would say these \$1 million deals would both fall in the larger and complex, basically, "Make me better." So in all 16 cases, they have some sort of security group. I think I've talked about this before, but the industry seems to really be changing from the perspective of more demand from above and ensuring that they are measuring and reducing risk in some way, shape or form and spending their money, their internal money in a way they can see a measurable impact. And I think part of that is reallocating their internal resources and gaining help where there are organizations that have, in our case, a diverse client base with a lot of intellectual property to help them in a -- whether it's prevention, detection, responding or transitioning to the cloud.

Operator

(Operator Instructions) Your next question is from Matt Hedberg from RBC Capital Markets.

Matthew John Swanson *RBC Capital Markets, LLC, Research Division - Senior Associate*

This is actually Matt Swanson on for Matt. Can we drill down a little bit on the MRR growth during the quarter? It seems like it's kind of been the thing that we've been chasing all year. And just what happened that was so successful this quarter after lowering guidance last quarter?

Michael R. Cote *Secureworks Corp. - CEO & President*

So what I would say happened this quarter, Matt, and this is Mike Cote, thanks for the question, was execution. We have been -- we invested in our sales organization. We focused on those fundamentals of people, productivity, coverage, messaging and methodology. And we ended up executing well in Q4. The opportunity in the market is clearly there. We focused, clearly -- we focused on renewing the clients on the solutions, where possible, and selling deals.

R. Wayne Jackson *Secureworks Corp. - CFO*

Yes. Matt, this is Wayne. I would click down on those as well. You're right, we lowered the MRR guidance last year -- or last quarter, but we had a strong pipe. We had ramped up the number of quota carriers. It was a -- actually, it was great to see execution came on board -- came into play, tenured sellers begin to come into play. Mike did focus on one thing in his earlier comments, the productivity for Q4 was really centered around some of the more tenured sellers, and we want to see that productivity expand across the entire sales force going forward. But in Q4, it all came together.

Matthew John Swanson *RBC Capital Markets, LLC, Research Division - Senior Associate*

That's great. And then kind of circling back on something you talked about, Europe. It sounds like a lot of the execution is company-specific, but I just was wondering if you've seen any uptick in conversation on GDPR.

Michael R. Cote *Secureworks Corp. - CEO & President*

Matt, Mike again. Yes, I mean GDPR is clearly a discussion point and it was involved in all of the conversations, starting with where we are from a GDPR perspective, which we will be fully compliant and have tested that compliance in advance. And we can clearly play a role in helping out our clients from a GDPR perspective. So I do think that it is -- it was a driver of sorts in the quarter.

Operator

There are no further questions at this time. I'll now turn the call back over to the presenters.



Teri L. Miller *Secureworks Corp. - VP & CAO*

Thank you, operator. Thank you again for joining us on today's call and for all of your questions. We appreciate your support, and we look forward to our first quarter call in early June. If we did not get to your question during the Q&A section, please don't hesitate to reach out to us for a follow-up.

Michael R. Cote *Secureworks Corp. - CEO & President*

Thanks you, everyone.

R. Wayne Jackson *Secureworks Corp. - CFO*

Thanks, everyone.

Michael R. Cote *Secureworks Corp. - CEO & President*

Have a good day.

Operator

Ladies and gentlemen, that concludes today's call. You may all now disconnect.

[1] Gartner, "Magic Quadrant for Managed Security Services, Worldwide", Toby Bussa, Kelly M. Kavanagh, Sid Deshpande, Pete Shoard, 27 February 2018. The report was formerly titled Magic Quadrant for Global MSSPs and Magic Quadrant for MSSPs, North America.

Gartner does not endorse any vendor, product or service depicted in its research publications, and does not advise technology users to select only those vendors with the highest ratings or other designation. Gartner research publications consist of the opinions of Gartner's research organization and should not be construed as statements of fact. Gartner disclaims all warranties, expressed or implied, with respect to this research, including any warranties of merchantability or fitness for a particular purpose.

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Briefs are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT BRIEFS REFLECTS THOMSON REUTERS'S SUBJECTIVE CONDENSED PARAPHRASE OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT BRIEF. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2018 Thomson Reuters. All Rights Reserved.

