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Guidewire Software, Inc. (GWRE)

Q1 2025 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings and welcome to the Guidewire First Quarter of Fiscal 2025 Financial Results Conference Call. As a reminder, this call is being recorded and will be posted on our Investor Relations page later today.

I would now like to turn the call over to Alex Hughes, Vice President of Investor Relations. Thank you, Alex. You may begin.

Alex Hughes

Vice President-Investor Relations, Guidewire Software, Inc.

Thank you, Grace. Hello, everyone. With me today is Mike Rosenbaum, Chief Executive Officer; Jeff Cooper, Chief Financial Officer; and John Mullen, President and Chief Revenue Officer, who will be with us for Q&A today on the call. A complete disclosure of our results can be found in our press release issued today, as well as in our related Form 8-K furnished to the SEC, both of which are available on the Investor Relations section of our website. Today's call is being recorded and a replay will be available following its conclusion.

Statements today include forward-looking ones regarding our financial results, product, customer demand, operations, the impact of local, national and geopolitical events on our business, and other matters. These statements are subject to risks, uncertainties, and assumptions are based on management's current expectations as of today and should not be relied upon as representing our views as of any subsequent date.

Please refer to the press release and risk factors and documents we file with the SEC, including our most recent Annual Report on Form 10-K, and our prior and forthcoming quarterly reports on Form 10-Q filed and to be filed

with the SEC for more information on risks, uncertainties and assumptions that may cause actual results to differ materially from those set forth in such statements.

We also will refer to certain non-GAAP financial measures to provide additional information to investors. All commentary on margins, profitability and expenses are on a non-GAAP basis, unless stated otherwise. A reconciliation of non-GAAP to GAAP measures is provided in our press release. Reconciliations and additional data are also posted in a supplement on our IR website.

Finally, this quarter, Investor Relations has decided to enter the current decade and conduct our earnings call on Zoom, rather than at Telebridge. This means we will manage the Q&A portion of today's call internally with the help of Grace moderating, who you just heard from, and me managing Q&A. Since it's our first go, please be patient with us as – if we encounter any short pauses in the handoffs during Q&A.

So with that, I will hand it off to Mike.

Mike Rosenbaum

Chief Executive Officer & Director, Guidewire Software, Inc.

Thank you, Alex. Good afternoon and thanks, everyone, for joining us today. Q1 was a very strong start to the year for us, and coming on the heels of a record breaking Q4, I'm excited about the continued and consistent momentum in our business. In November, we had the opportunity to connect with thousands of our customers and partners at our Industry conference, Connections, and also released Las Leñas, our 12th cloud release. Connections is an opportunity for us to present our company and product vision to the world, and the feedback has been universally positive. It was gratifying to see the results of our team's efforts come together. And I think it appropriate to call out four key themes that I took from the event and I believe are driving our company right now.

First, we continued to see strong demand from our cloud-based solutions, particularly at the high end of the market. Second, this demand is being driven by the increasing maturity of our Cloud Platform, particularly around the ease of updates, which is driving referenceability throughout our cloud customer base. Third, the improved agility and flexibility that our Cloud Platform and solutions deliver is resonating with the industry's growing demand for pace and speed in delivering analytics and AI powered innovation. Fourth, our partner ecosystem, both in terms of consulting partners and marketplace solutions, continues to rally around our Cloud Platform, which is extending and accelerating our reach and impact. Finally, unrelated to Connections but important to call out, we continued to create leverage in our operating model, as we drive greater efficiency running Guidewire Cloud Platform. I'll touch on each of these briefly before handing it over to Jeff to discuss the financials.

Cloud demand remains strong with nine deals in Q1. Our results were particularly strong at the high end of the market. Of the seven total InsuranceSuite Cloud deals, five were with Tier-1 insurers. This included two deals at Zurich Insurance Group, a top three global commercial insurer. In the quarter, we signed a global framework agreement with Zurich that streamlines the decision process for each of its local and country-specific entities to adopt Guidewire Cloud. In conjunction with this agreement, Guidewire Cloud was adopted within two Zurich entities, one for the full suite at an entity focused on large corporate and commercial lines, and another for ClaimCenter at Zurich Australia. This agreement and these wins speak to our scale and ability to serve the largest insurers in the world.

We closed another three InsuranceSuite deals at Tier-1 insurers. Arch Insurance's middle market commercial and entertainment business selected InsuranceSuite on Guidewire Cloud. Also, one of the world's largest insurance companies based in Australia selected InsuranceSuite to replace the legacy system for the commercial lines of

business. And a European mobility insurance arm of a global Tier-1 insurer elected to adopt InsuranceSuite for a multi-country rollout across Europe.

As we have discussed before, these relationships take years to develop and are expected to last decades. We are all excited about the momentum in this segment of the market and the opportunity to serve some incredible new customers.

Our continued momentum with Tier-1 insurers is great, but the international momentum is also exciting and aligns to a strategic focus we've outlined previously. In our European region, we added three cloud customers, including the ones I just mentioned, and I was particularly pleased to earn the trust of the Baloise Group, a long-time self-managed customer who chose to migrate to Guidewire Cloud Platform while expanding to the full suite for its European entities.

In the Asia-Pacific region, it was another strong quarter in Australia and New Zealand with two Tier-1 deals mentioned. I'm very pleased to see the investments we've made in this region continue to pay off. We also had another good quarter for InsuranceNow, which supports smaller insurance customers with one net new win and an expansion in the quarter.

Our continued strong demand is primarily driven by the increasing maturity and referenceability of the Guidewire Cloud Platform and our cloud-based solutions. This was one of the main takeaways from Connections. Simply put, customers are successful with Guidewire, and specifically, Guidewire Cloud. And with more of our overall customer base now on cloud, customers who have been waiting for the right time to see the success and getting more serious about their plans for modernization.

The CTO of Travelers shared her experience migrating to PolicyCenter on Guidewire Cloud, and implored others to get started now, saying the faster and earlier you move, the sooner you'll drive growth and innovation. The COO of IAG, Australia's largest insurer and operator of 26 insurance brands, spoke about the greater efficiency and innovation they unlocked by consolidating to a single claims platform with intelligent automation. Their team has gone from taking 22 minutes to report a claim to just 90 seconds, and more importantly, has made it vastly easier for thousands of employees to develop and innovate on our platform.

We also had the opportunity to connect with a leadership contingent from Japan at the event and conducted a specific strategy session for this market. It was exciting to see this level of engagement from our Japanese customers, and we're excited about the opportunity to further our commitment to the Japanese insurance market.

The maturity of our Cloud Platform also creates the baseline P&C insurers need to innovate. Rapid technology advances around generative AI are underscoring the need for a modern cloud platform. At Connections, we shared our vision and plans to infuse generative AI in our platform and solutions to improve developer productivity and accelerate underwriting and claims processes. The feedback we received from customers was incredibly positive, as I think customers increasingly appreciate the need to run an agile and flexible core platform with modern APIs that allow them to innovate and stay competitive. The pace at which generative AI-driven capabilities are evolving is unprecedented, and taking advantage of this potential requires a modern core platform.

This fact, together with the maturity of Guidewire Cloud Platform, especially around being able to take releases more easily, has led to very positive customer engagement and I think shifted the nature of many of our cloud migration conversations. It's great to see the maturity and momentum of our platform continue to grow. And

underscoring this was Gartner's recent Magic Quadrant for Software-as-a-Service P&C Core Platforms North America, which showed InsuranceSuite as the clear leader.

Our partner community is a key element of our success, and we continue to see great momentum with both SI partners and technology partners. The presence of 33 SI partners, including PwC, Deloitte, Capgemini, Accenture, EY, Sollers and Cognizant was very impressive to see. It was clear that we bring to the table a unique strength relative to our competitors in the space.

Our intention is to focus on being a best-in-class software company and build products that can be implemented successfully by partners. This strategy isn't just achieved by creating great products. It requires creating a one-of-a-kind partner ecosystem that ultimately creates far more successful customers.

It was also great to see marketplace partners really step up and use the event as an opportunity to launch new technology and integrations with us. For example, Hi Marley launched a conversational first notice of loss experience that leverages automation and AI to dramatically increase the ease and speed of starting a claim. In addition, Fox announced its leveraging Guidewire Cloud Platform's integration framework to offer a pre-built integration that automatically extracts data from box files and populates corresponding InsuranceSuite records. Insurers can now automatically categorize and analyze claims documents, extracting critical information such as policy numbers, incident details and customer data to accelerate claims processing and enhance accuracy. Partnerships like these increase my confidence that our approach to aggressively partner with companies across the insurance lifecycle is working, and like I said before, leading to better customer outcomes and success.

Finally, as we grow adoption and deployments of Guidewire Cloud Platform, we continued to demonstrate increasing leverage in our business model. It is great to see expanding operating efficiency play out, with subscription and support gross margins reaching 70% in the first quarter, which Jeff will talk about in more detail. This continued operating execution gives us confidence in the future and the freedom to begin to work on what's next.

To conclude, I'd say we continue to build a very attractive business with a blue chip customer base and best-in-class customer retention that's based on a platform designed to continually deliver greater innovation and value to our customers in the P&C industry. We are at a point where pace of change makes a platform like this more important than ever for insurers. And we believe this positions us to build a business that delivers an attractive combination of durable growth and margin.

And with that, I'll turn it over to Jeff to discuss the financials.

Jeff Cooper

Chief Financial Officer, Guidewire Software, Inc.

Thanks, Mike. We're off to a great start in fiscal 2025. I want to touch on four key financial highlights before I jump into the details of the quarter. First, ARR ended at the high end of our outlook at \$874 million. Second, subscription and support revenue growth accelerated to 33% in Q1. Third, subscription and support gross margin hit 70% in the quarter. And fourth, total revenue on a trailing 12-month basis surpassed \$1 billion. Combining these financial highlights with the energy we just experienced coming out of Connections, it is clearly an exciting time to be at Guidewire.

Now, let me dive into the details. Total revenue was \$263 million, above the high end of our outlook and up 27% year-over-year. Our total revenue beat was due to higher than expected subscription and support revenue and services revenue.

Subscription and support revenue finished Q1 at \$170 million, reflecting 33% year-over-year growth, which is the highest growth rate in two years. This is a reflection of our continued InsuranceSuite Cloud momentum. Services revenue finished at \$56 million, as healthy services bookings translated into higher utilization rates.

Turning to profitability for the first quarter, which we will discuss on a non-GAAP basis, unless stated otherwise, gross profit was \$167 million, representing 38% year-over-year growth. Overall gross margin was 63%, compared with 58% a year ago and 42% in Q1 of fiscal 2023. Our progress on profitability has been fantastic.

Subscription and support gross margin was 70% compared to 65% a year ago. This was ahead of our expectations due to higher than expected revenue and continued progress on platform efficiency. Services gross margin was 20% compared to 10% a year ago. This profitability benefited from strong utilization rates and lower subcontractor costs. All this positive momentum on gross margins led to an operating profit of \$34.7 million. This is a strong result when compared with our outlook of \$21 million at the midpoint. About \$12 million of this beat came from the gross profit line, with the remainder coming from operating expense discipline.

Overall stock-based compensation was \$38 million, up 5% from Q1 of last year and higher than expectations due to an adjustment in our accrual for prior year performance-based stock grants and share price appreciation prior to grant date for recent employee RSU grants.

We ended the quarter with over \$1.5 billion in cash, cash equivalents and investments. During the quarter, we completed a \$690 million convertible debt offering. Using a portion of the net proceeds of this offering, we retired about 30% of our existing convertible notes that are maturing in March of 2025. The remaining converts due in 2025 are expected to be net share settled at maturity.

On December 2, we established a \$300 million revolving credit facility. This facility gives us incremental flexibility to ensure we have liquidity necessary to pursue inorganic growth while minimizing shareholder dilution.

Operating cash flow ended the quarter at negative \$62 million. As a reminder, annual employee bonuses and commission expenses related to Q4 sales are paid out in Q1, and as a result, Q1 cash flow is always lower than the other quarters in the fiscal year.

Now, let me go through our updated outlook for fiscal year 2025. Starting with the top line, we are very pleased with our first quarter performance and feel confident in our pipeline and our ability to hit our annual targets. Given we are just one quarter into the year, we are maintaining our annual outlook for ARR of \$995 million to \$1.005 billion for total revenue. For total revenue, we now expect between \$1.155 billion and \$1.167 billion. We expect approximately \$648 million in subscription revenue and \$713 million in subscription and support revenue. Given higher than expected services revenue in Q1 and improving utilization, we now expect services revenue to be approximately \$205 million.

Turning to margins and profitability, which we will discuss on a non-GAAP basis, we are increasing our subscription and support gross margin expectations to be approximately 69% for the year, up from the 68% we discussed last quarter. We expect services gross margins of approximately 12% and overall gross margins to be approximately 65% for the full year.

As a result of raising our revenue outlook, we are also lifting our outlook for operating income. We expect GAAP operating income of between breakeven and \$12 million, and non-GAAP operating income of between \$164 million and \$176 million for the fiscal year. We expect stock-based compensation to be approximately \$159

million, representing 9% growth year-over-year. We still expect cash flow from operations for the year to be between \$220 million and \$250 million.

Turning to our outlook for Q2, we expect ARR to finish between \$909 million and \$914 million. Our outlook for total revenue in Q2 is between \$282 million and \$288 million. We expect subscription and support revenue of approximately \$175 million and services revenue of approximately \$48 million. We expect subscription and support margins of approximately 68%, services margins to be around 6%, and total gross margins around 64%. Our outlook for non-GAAP operating income is between \$39 million and \$45 million.

In summary, Q1 was a great start to the year and we are very excited for what is ahead.

Alex, you can now open the call for questions.

QUESTION AND ANSWER SECTION

Alex Hughes

Vice President-Investor Relations, Guidewire Software, Inc.

A

All right. Thanks, Jeff. Our first question comes from the line of Dylan Becker at William Blair.

Dylan Becker

Analyst, William Blair & Co. LLC

Q

Hey, gentlemen. Hopefully, you can hear me here. Appreciate the question. Mike, you touched on this at the start. Obviously, we were at Connections and it was very clear the enthusiasm from customers and partners that you talked to. I'm wondering if you could dive into the importance. You called out kind of now roughly half of the base along this cloud migration journey. I think the vast majority of those are on kind of more frequent versions of the software as well. So, how that kind of unlocks more of this ecosystem enthusiasm and how it contributes confidence and your aspirational goal of getting 100% of this ecosystem converted to the cloud over time?

Mike Rosenbaum

Chief Executive Officer & Director, Guidewire Software, Inc.

A

Yeah. Thanks, Dylan. Appreciate the question. So yeah, I think one of the things that's been – it's been hard over the past few years is just the use case is not an experimental use case, that the customers we serve in the industry and the use case that we serve for customers is incredibly serious. And so, they take the decision to move to cloud very seriously and they want to see a track record. Many of these customers want to see a track record of success. And so, it's kind of one of the things that we're very proud of, is just how well we've executed and how consistently we've executed with our cloud programs. They haven't all gone perfectly, but I can genuinely say that they've all gone well. And everybody that's made that decision is happy that they made the decision. And so, that just really helps us have the conversations with the customers that are still on-prem, that are still thinking about when's the right quarter and when's the right year for them to move. And it just adds to the confidence and it reduces the perceived risk that they're taking in going to a platform like ours.

Now, the other side of your question, which we touched on at the Connections event, is not only are we getting the programs live and not only are they running successfully in production, but we're actually able to keep the customers on current release versions of the product, which is slightly different than basically the way the distribution of releases existed in our on-prem customer base. We're doing a lot technically to validate the implementations and validate the new versions of the software that we write so that we can do these updates

more frequently, faster and cheaper for all of our cloud customers. And so, that just adds to the benefit that the on-prem customers think about – that expect that they'll see when they get to the cloud. It improves the value proposition and it increases the likelihood that they're going to make that decision.

And so, you add all that up and it's just kind of changing the nature of the conversations we're having. It's never going to go as fast as we want. We've got to be patient and we've got to work with the customers based on the set of priorities that they have. But I do genuinely believe that we are going to get 100% of our customer base to our cloud. And that's a pretty amazing thing to say when you think about the scope of what Guidewire has achieved over its 20-year history. I can legitimately say that there's a path to that and we're committed to that, and I can see it happening. And so, it's kind of exciting. It's like – it's going to take a long time and – but we're going to do it, and I think it speaks to the sort of commitment we make to the industry and our customer base.

So anyway, hopefully that helps. Thanks for the question.

Dylan Becker

Analyst, William Blair & Co. LLC

Q

No, no, it does. Appreciate it. And it was great to see the enthusiasm at the event. Maybe, Jeff, as a segue to you off of that, you called out the acceleration in subscription and support revenues as a function of some of these larger Tier-1 deals, obviously, 70% gross margin there tracking well ahead, and how this kind of gives confidence, and obviously, the kind of financial implications of this long-term normalization and some of your longer-term targets there. Thanks, guys. Appreciate it.

Alex Hughes

Vice President-Investor Relations, Guidewire Software, Inc.

A

Sorry. Next question comes from Ken Wong of Oppenheimer.

Ken Wong

Analyst, Oppenheimer & Co., Inc.

Q

Hey, great. Thanks for taking my question. Mike, you called out the Zurich deal in your prepared remarks, and I couldn't help but notice global framework agreement being tossed out there. I guess maybe help us understand the significance of a global framework. How much of this is something that might materialize near term financially versus something that we might see kind of flowing in more medium, long-term as this framework gets rolled out?

Mike Rosenbaum

Chief Executive Officer & Director, Guidewire Software, Inc.

A

Yeah. Thanks for the question, Ken. So obviously, Zurich is a critical customer for us globally across many countries and many instances. And we've had success – we've had cloud success with various entities in – as part of the Zurich Group over the past few years. But as our momentum kind of started to pick up and as the concept that this is – this cloud offering that we have is really working, we began to have conversations with the Zurich Group, the global kind of, call it, oversight entity that looks to create partnerships worldwide that supports every single entity. We started to have conversations with them about what we could do to facilitate the conversations and the negotiations and the structuring of the deals with each one of the individual entities. And so, somewhat, this is a mechanism for us to create a more fluid conversation with each of those entities as we proceed and grease the skids, so to speak, about the decision to move to cloud.

So, we still have to earn that business with each one of those entities, and we're certainly committed to doing it, but it should make the sales cycles a lot more straightforward, because basically, we've negotiated a structure

centrally that we can share across all of those entities. And it was nice because that agreement kind of lined up to two short-term deals that are called out in the prepared remarks. Both of those deals were things that we had been discussing. But once we had the global agreement in place, it became easier for us to get those two deals completed. And I don't want to project, but it's certainly not going to slow down our momentum, our sales momentum with Zurich. It could only speed it up. And I think it's just a great, I don't know, it represents just the incredible strength of this partnership and what we think we can create with Zurich worldwide. It's just an incredible milestone for us. And to have earned their trust to like create that structure, I was really proud to get to that point.

Ken Wong*Analyst, Oppenheimer & Co., Inc.*

Q

Great. Thank you. Super helpful. And Jeff, I wanted to maybe pick on the – or dig in to the subscription and support gross margins, really meaningful step up to 70% this quarter. You called out some of the tailwinds from top line and expenses. But any one-time uplift that we should be aware of? I noticed you guided it to step back a little next quarter. Yeah. Any help there would be great.

Jeff Cooper*Chief Financial Officer, Guidewire Software, Inc.*

A

Sure. Yeah. I mean, there's a couple things to know. First, we are modeling some significant increased customer usage of the platform as we move throughout the year as we see more and more customers go live. And so, that does have an impact. The second thing that's a little bit more nuanced is we had some engineers that were building cloud migration tooling, and some of those engineers transitioned their focus to supporting cloud customers. And as a result, the expense associated with those engineers moved from R&D to cloud cogs. That impact occurred towards the end of Q1. It's pretty common for us with the function of DevOps to take a regular look at how people spend their time and how we're allocating the appropriate expenses associated with their time. And so, that did happen. That had an impact. If you look at that impact throughout the whole year, it adds up to about a kind of 1 percentage impact to gross margin that didn't impact Q1 but will impact the rest of the year. And so, you take that together, that's the reason why we're not expecting to sustain at 70%, but still tracking a little bit ahead of our expectations for the year.

Ken Wong*Analyst, Oppenheimer & Co., Inc.*

Q

Fantastic. Thanks for the color.

Alex Hughes*Vice President-Investor Relations, Guidewire Software, Inc.*

A

Great. Our next question comes from Parker Lane at Stifel.

Jeffrey Parker Lane*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Hey. Can you guys hear me okay?

Alex Hughes*Vice President-Investor Relations, Guidewire Software, Inc.*

A

Yes.

Mike Rosenbaum

Chief Executive Officer & Director, Guidewire Software, Inc.

Yes.

A

Jeff Cooper

Chief Financial Officer, Guidewire Software, Inc.

Yes.

A

Jeffrey Parker Lane

Analyst, Stifel, Nicolaus & Co., Inc.

Perfect. Thanks for taking the question here. Jeff, looking at the 1Q performance and the implied guide for the full year in services, I was wondering if you could dive into that dynamic of growth a little bit more this year and sort of comment on how close you are to the ideal split of services work being done by partners versus your internal teams.

Q

Jeff Cooper

Chief Financial Officer, Guidewire Software, Inc.

Yeah. I think in general, when we've talked about this, we've indicated that it's really critical for us to have a high performing services team. This is a strategic asset for us. And we have capacity to do a little bit over \$200 million. And as we established the outlook for this year, we thought it would take a little time to build back to that level. But with the guidance that we've given in – at the end of this quarter is – we now are kind of operating at a higher utilization than what we'd expected.

A

I think we're finding a healthy balance right now between the work that our teams are engaging in and the work that the partners are engaged in. The partners continue to lead most of these programs. And as we look at utilization rates in Q1 and as we look kind of throughout the rest of the year, I expect utilization to take off a little bit. We're not expecting to be at 20% margins as we move through the year. But it was a really strong first quarter for us.

And John Mullen is here as well and he can offer up some comments on that.

John Mullen

President & Chief Revenue Officer, Guidewire Software, Inc.

I'll just add that I agree, we're reaching that balance point where seeing what's ahead of us gives us that chance to look better at our utilization and what we do from a subcontracting standpoint. The unique part about Q1 was really Q4. We had some really nice sized deals in Q4 that created a hot start to the year. So, we're a little bit ahead of schedule on utilization. But we're finding that balance Jeff is talking about and we feel really good about the work that that team has done. And also the really tight partnership with the systems integrators to make sure that we've got the right mix to ensure success across all of these deals.

A

Jeffrey Parker Lane

Analyst, Stifel, Nicolaus & Co., Inc.

Appreciate the feedback and thanks for taking the question.

Q

Mike Rosenbaum

Chief Executive Officer & Director, Guidewire Software, Inc.

A

Thank you.

Alex Hughes

Vice President-Investor Relations, Guidewire Software, Inc.

A

Thanks, Parker. Our next question comes from Alex Sklar of Raymond James.

Alexander Sklar

Analyst, Raymond James & Associates, Inc.

Q

Thank you. Mike, I just want to follow-up on Dylan's question earlier on the cloud migration pacing. You called out some of the highlights around the referenceability, the customers staying more current, AI is kind of a driver – an overall driver for customers that want to do anything with AI going in the future. Is there any change coming out of Connections, though, just in terms of your visibility over the kind of next to three to five-year window as far as pacing of cloud migrations?

Mike Rosenbaum

Chief Executive Officer & Director, Guidewire Software, Inc.

A

I would say nothing's changed if you look out three to five years. I think we've had a couple of conversations coming out of Connections where you could say things have improved and there's a little bit more of a timeline associated with planning. And so, like I said, it certainly helps kind of solidify our expectations for opportunities through the remainder of the fiscal year.

I think the other characteristic of this is that we have begun to be more clear about what the long-term expectations should be for our ability to support on-prem customers out and beyond three to five years and exactly what that looks like and starting to have real conversations with customers about what they should expect and how they should start to plan. And so, I would say like the referenceability, the excitement about the product, our ability to support and run these workloads successfully, all of that helps. But it also kind of relates to just what is the final outcome of these on-prem implementations. And that conversation we have with all those customers definitely stretches out five years. We make a plan for what our – what we expect the opportunity will look like each quarter out for the next couple years, and we continue to hone that with our sales organization and our customer success leaders. So, I would say Connections helped a little, but it hasn't changed it dramatically.

Alexander Sklar

Analyst, Raymond James & Associates, Inc.

Q

Okay.

John Mullen

President & Chief Revenue Officer, Guidewire Software, Inc.

A

I'll add one quick point on that. I think Mike's keynote message balanced off trust and vision, and so much of the conversations we've had have been about gaining trust and proof points. And it does materially start to shift towards that vision for how our brands work together, us and customers and prospects and the industry at large work together to unlock opportunity.

Just adding that times up really well with the pressure that exists right now, competitive pressure that exists right now in general insurance, property and casualty insurance, the need for agility. The need for more precise decision making is very real. And having the opportunity to sit across the table from these customers and prospects and map out how we can work together and continue to invest in our R&D to help them solve that

problem, is – it gives me a tremendous amount of optimism about how we continue to work together with them in a more strategic context than just proving out the value of the platform asset.

Alexander Sklar

Analyst, Raymond James & Associates, Inc.

Q

Okay. Great color. Jeff, maybe just one follow-up for you, just in terms of the really strong Tier-1 activity this quarter, any color on what those look like relative to the kind of the ARR increase? Any of them that kind of aren't hitting in this Q1 ARR number or any different ramp schedules versus what you've kind of historically booked with Tier-1s in the past?

Jeff Cooper

Chief Financial Officer, Guidewire Software, Inc.

A

Yeah. So, there was one deal in particular where the deal closed this quarter but the ARR doesn't start until next quarter. And so, that was one nuance in the quarter. But other than that, it was pretty typical blocking and tackling. Pleased with the progress in Q1. If you're hinting at kind of the size of the ARR outperformance in the quarter, Q1, we did have a little bit higher churn for the year than what we expect for the rest of the year, and that's kind of considered into our guidance and our forecast. And then, the backlog in Q1 is usually pretty slow, and then that ramps throughout the year, and that's what we expect of this year as well.

Alexander Sklar

Analyst, Raymond James & Associates, Inc.

Q

Got it. I appreciate that color. And it wasn't suggestive of the upside of just five Tier-1s the way they were laid out, some really large. So, I'm curious if there's anything different on how those were going to hit ARR over the next few years. But that's perfect. Thanks, Jeff.

Alex Hughes

Vice President-Investor Relations, Guidewire Software, Inc.

A

Great. Our next question comes from David Unger from Michael Turrin's team at Wells Fargo.

David Unger

Analyst, Wells Fargo Securities LLC

Q

Thank you very much. So< great to be in Connections and good to see the continued success and callout of the Tier-1 wins. We got to spend some time with Tier-2 and Tier-3 vendors at Connections. Can you just talk through their engagement levels out of Connections this year versus prior years? Thanks.

John Mullen

President & Chief Revenue Officer, Guidewire Software, Inc.

A

Yeah...

Mike Rosenbaum

Chief Executive Officer & Director, Guidewire Software, Inc.

A

Let me say something [ph] further and I can let (34:19) John give you a perspective. He's spent as much or more time with customers at Connections as I did. I would say we called out the Tier-1s just because it's so strategic and there's such a high percentage of the overall premium in the industry that relates to Tier-1 carriers. But we've had tons of success with carriers of all sizes since – not just the Tier-1 space. Connections is obviously a great opportunity for us to connect with people one-to-one and find out how are the projects going and what feedback

do they have about our roadmap and what we're doing. And I would say I'm just very, very positive on the direction that we're headed and how it's aligned to where our customers want us to be. I mean, we're not perfect and we definitely get feedback at these events about where we can improve. And we work hard to listen as closely as we can and adjust our approach to delivering on the programs and delivering on the roadmap, such that these implementations are successful and fast as possible.

But I would say there's just a lot – there's a lot of energy behind the idea that, okay, we've got PolicyCenter and ClaimCenter and BillingCenter and InsuranceNow running in the cloud, and we've got the update system working, and the system is generally working. And now, we can start to think about what are we doing for your claims experience and your claims adjusters and how are we making sure you can manage indemnity more effectively and what are we doing around underwriting and helping your underwriters and helping your actuaries manage your rating systems more effectively. And all that kind of like insurance functionality that we haven't been as focused on over the past five years is starting to bubble its way back up the road – up the priority list and into the roadmap, and that's pretty exciting. When you get that kind of feedback from those customers at Connections, it's great, it's validating. And so, that was my big takeaway.

But I'll let John give a comment because he's spent a lot of time with these customers there, too.

John Mullen

President & Chief Revenue Officer, Guidewire Software, Inc.

A

Yeah. I'll start with the Tier-3s. I love the conversations and the operating principle with the Tier-3s simply because they exercise the platform and the application so aggressively. It's such a critical element of their business that we learn so much in the operations with them. Great feedback, great opportunity to prioritize our R&D roadmap. And the way we stand shoulder-to-shoulder to drive value with those Tier-3s is absolutely critical to our kind of teaming coexistence. So, that's fun. And I see the – I do see the Tier-3s really moving aggressively. I'll come back to that in a second.

The Tier-2s, certainly unlocking value, as Mike mentioned, is becoming so much more important to them. The ability to talk about insurance features and functions, risk selection, pricing, rating, the things that we're talking about that drive their business and their ability to compete really aggressively brings the Tier-2s, which is such a big part of Guidewire's 20-year history, really brings it to that how do we shape the next chapters together.

The thing I'd take away from Connections more than anything else with these customers is for the smaller customers, it's true that working with us, they can operate at a level of scale and leverage that was maybe not available without the partnership. And for those that are very large, we're unlocking a level of agility that would be quite difficult for them to achieve standalone. So, those two things together is – it creates a great basis for conversation and planning.

David Unger

Analyst, Wells Fargo Securities LLC

Q

So, you [ph] lead the way (37:51) into my next question, which was, obviously, great demos being shown at Connections. And any initial stats you could share as it relates to customer engagement coming off with gen AI and what that could be for the future? Just wondering how that compares across tiers in terms of customer engagement out of Connections related to gen AI?

John Mullen

President & Chief Revenue Officer, Guidewire Software, Inc.

A

Well, on a conversation basis, I would say statistically speaking, 100% of our customer conversations have some implications on what their plans are for gen AI, and maybe more specifically, decision making inside the enterprise. More and more, it's becoming part of the business case that we write together to take that next – that really big important step of addressing the core processing environment and modernizing the core processing environment to unlock that value. 100% is – I don't think is an overstatement. What percentage of those work into the business case to make that next important move is critical for those that are looking at either a net new or a migration. For those that are customers, the intensity and frequency of conversation is very prevalent in both our customer success organization and our product organization and our analytics organization. And the number of conversations we're having in kind of, I don't want to call them co-design, but co-conceptualizing solutions for the market, has increased quite a bit in the last six months.

Mike Rosenbaum*Chief Executive Officer & Director, Guidewire Software, Inc.*

A

Yeah. And I could just give you a quick perspective is generative AI is a tool that can be applied in a thousand ways to the insurance industry. And so, like every customer we talk to is doing something, doing some level of experimentation, some have it in production in certain use cases. But everybody is out there doing different things, trying to learn from one another, trying to learn from partners, trying to learn from Guidewire. And like aligning what we're learning and what we're doing with what they're learning and what they're doing, it's all very interesting. But there isn't like a deployed generative AI step. Like literally, that will be done times a thousand different use cases across the industry, across countries, across tiers. It's a very ubiquitous technology capability that will be applied all over the insurance lifecycle. And it's kind of fun to get to sit down with people and start to think about where we might apply this, especially given this like Cloud Platform that's like set up to enable us to deliver this innovation in a much more fluid way than we were able to do it before.

David Unger*Analyst, Wells Fargo Securities LLC*

Q

I appreciate all the detail. Thank you.

Alex Hughes*Vice President-Investor Relations, Guidewire Software, Inc.*

A

Great. Our next question comes from Aaron Kimson of JMP Securities.

Aaron Kimson*Analyst, Citizens JMP Securities LLC*

Q

Great. Thanks for the questions and having us in Nashville last month. I know it's early on gen AI and that was part of the vision piece of the Connections keynote. But can you help us think about what the pricing models for gen AI use cases may look like?

Mike Rosenbaum*Chief Executive Officer & Director, Guidewire Software, Inc.*

A

I think it's premature for us to talk about it. It's just because we have a lot of options that we'll look at, different ways we could look at packaging it. And so, it's just – there's just like so many ways that this might go that it's probably premature for me to describe it. And I also think I would connect you back to the previous conversation. I think it's almost like if you say like how does the Internet or Web browsers interact with your technology, and it's like, well, it's everywhere, right? And so, like there's going to be components, there's going to be to be solutions and products that are packaged and priced that are powered by generative AI. And they'll – those prices and packages will relate to the solutions and products more so than they will relate to the enabling technology, the

enabling capability, which will certainly be like a factor in how much it costs to run and how much it costs to build and deliver. But it's going to be far more nuanced than just like this is how we price generative AI at Guidewire.

Aaron Kimson*Analyst, Citizens JMP Securities LLC*

Q

Understood. And then, Mike, you mentioned recently you have 122 customers running workers' comp on your platform. What type of activity are you seeing within that segment of the P&C market, and what's the incremental opportunity with your existing customer base like for workers' comp?

Mike Rosenbaum*Chief Executive Officer & Director, Guidewire Software, Inc.*

A

Well, so there's an existing opportunity to expand within the customer base. There's also net new opportunity for modernization activity where insurance carriers that are running workers' comp lines and want a modern platform, and we're tracking both of those things uniquely. The other side of this is that there's also, we're uncovering opportunities to enhance the product and improve with data and analytic solutions in workers' compensation. And then there's also, I think very interesting what I guess I would call like networked or common requirements across multiple workers' comp carriers where they can come together and say, hey, if Guidewire can work with us to do this centrally and then apply it generally across all of our workers' comp customers, it can provide a big lift and can provide a big benefit. I think that it's just very – I called it out just because we're starting to get feedback from customers that, hey, there is some unique requirements here and you have a critical mass of customers, and so we deserve some attention. And if you focused on it, you might be able to unlock some new sales activity, but also, we might be able to do a better job serving our existing customers. And it's kind of we spend a year looking at this and we have an incredible leader at the company named Laura Drabik who's been driving this for us and pulling together a plan across function that we're pretty excited about. And so, I hope that gives you a bit of a flavor for why we called it out, is like I really think it's going to become a more important part of our customer base and the use cases people kind of attack with the platform.

Aaron Kimson*Analyst, Citizens JMP Securities LLC*

Q

That's really helpful. Thank you.

Alex Hughes*Vice President-Investor Relations, Guidewire Software, Inc.*

A

Great. Our next question comes from Alexei Gogolev of JPMorgan.

Alexei Gogolev*Analyst, JPMorgan Bank International LLC (Moscow)*

Q

Hello, everyone. Could you provide an update on fully ramped ARR growth levels? Now that you're in entering sort of the back half of those large contracts, when would you expect headline ARR and the ramped ARR growth to begin to converge?

Jeff Cooper*Chief Financial Officer, Guidewire Software, Inc.*

A

Yeah. Alexei, we only comment on fully ramped ARR on an annual basis. The one thing I would comment is it was a very strong Q1 for us with respect to overall bookings activity. And so, that got us off to a good start. But we really measure ourselves with that particular metric on an annual basis. So, we'll comment on that at year-end.

Alexei Gogolev

Analyst, JPMorgan Bank International LLC (Moscow)

Q

Thank you, Jeff. And another question, could you elaborate a bit more on some of this cost optimization, where you were moving resources around?

Jeff Cooper

Chief Financial Officer, Guidewire Software, Inc.

A

Sure.

Alexei Gogolev

Analyst, JPMorgan Bank International LLC (Moscow)

Q

Does that mean that you can go well beyond \$1 billion in ARR with limited additional hirings?

Jeff Cooper

Chief Financial Officer, Guidewire Software, Inc.

A

Yeah. I mean, so we have a – we run a cloud ops – cloud operations team and a dev team that formulates how we think about DevOps, and we do regular assessments of where those engineers are spending their time. And from time to time, we have folks that are really building capabilities that fit more appropriately into R&D, and then we looked at some of the – some of these – what these roles in particular were site engineers, and they were more focused on supporting specific customers, and so moved them into the cost of goods sold line on the income statement. And this is pretty typical for us to – we don't like to see movement too much, but we do assessments on a regular basis with our accounting team to make sure that those are all appropriately resourced.

It does – I think the way we run it, we do have some flexibility in terms of how we manage that team and we can shift resources based on where they are needed. And so, I think the team has done a good job in that capacity. But that's just what happened in the quarter, and I flagged that just because I wanted to help you all understand a little bit as to why the margin guide is a little bit below where we landed in Q1.

Alexei Gogolev

Analyst, JPMorgan Bank International LLC (Moscow)

Q

Okay. Thank you, Jeff.

Jeff Cooper

Chief Financial Officer, Guidewire Software, Inc.

A

Yes.

Alex Hughes

Vice President-Investor Relations, Guidewire Software, Inc.

A

Okay, great. That's the last question I saw. So, I'll hand it over to Mike for closing comment.

Mike Rosenbaum

Chief Executive Officer & Director, Guidewire Software, Inc.

Well, thanks, everybody, for participating in the call today. We couldn't be happier with the start to the year. It was great Q1 and it was incredible in Connections. We're excited about the prospects for the rest of the fiscal year,

and we look forward to seeing everybody over the course of the next few months and maybe at the end of Q2. So thanks, everybody, very much.

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