H1 FY2024 Results Presentation Transcript

Luk Janssens, Head of IR

Slide 1
Hello everyone and welcome to Darktrace's half year results presentation for our financial year 2024, for the 6 months ending 31 December 2023.

Slide 2
In this presentation we'll be hearing from Poppy Gustafsson, our CEO, and Cathy Graham, our CFO. At 1pm GMT we will host a Q+A session with Poppy, Cathy, myself and Max Heinemeyer, our Chief Product Officer for our analyst and investor community. We will not replay this video on the call, so please ensure you watch the whole thing to maximise the session later.

Slide 3
Here is a disclaimer for you to read in your own time. With that, I will hand over to Poppy to give her reflections on what today's results mean for the business.

Poppy Gustafsson, CEO

Slide 4
Hello everyone.

AI may now have been around for more than 50 years, but today it is the protagonist in many political, philosophical, ethical & corporate debates.

These conversations are lively and insightful, but it can often feel like they are raising more questions than answers. Is AI biased? How will AI change the way we apply copyright? How will it change our jobs? *How does it actually work?*

The fact that AI leads to more questions than answers isn't a weakness – it's a tribute to the rapid rate of innovation that we are living through. The more questions we ask, the better the technology we can invent.

At such an exciting time, I am incredibly privileged to be leading an AI company and I would like to take the opportunity to give the Darktrace perspective on where the technology is today. Before I dive in, I wanted to touch on some of the highlights the business has seen in the first half of this financial year.

- Our ARR has grown by 24.4% year on year to over $702m
- Likewise, our revenue has grown by 27.4% year on year to $330.3m
- Average contract value has increased by 10.2%, as we upsell into more customers; and
- We have increased our guidance for FY 24 revenue and margin expectations

What I'm pleased to say is that these numbers reflect a real inflection point in our growth journey as guidance indicates returning to growth in our H2. We have invested in our business and returned what is hopefully the start of a multi-year growth period for us.

We are happy to see 24%+ARR growth, improved churn and net revenue retention rate, and clear evidence of the business moving closer to it's mid term margin target of mid 20s%.

These improvements are in part thanks to the significant Go-To-Market changes we made starting to bear fruit, which I will touch on in more detail later in this presentation.

But let me return to our fundamentally unique approach to artificial intelligence.

Slide 5
The recent ubiquity of AI can be attributed to developments in compute power. The amount of compute used to train many of the AI systems we see hitting the headlines has increased by a factor of 350 million over the past 13 years[1].

This means that today, we can interact with AI in real time; conversations with LLM tools like ChatGPT feel more human than ever before. It's probably why many of us find ourselves saying 'please' and 'thank you' when making requests of Siri or Alexa…

The secret sauce of AI, however, isn't just clever maths and compute power; it needs fuel, and that fuel is data.

Slide 6
As the industry races to consolidate datasets ready to fuel the LLMs of the future, governments and regulators are raising a powerful eyebrow.

The Biden Administration's Executive Order on AI spotlighted the cybersecurity of AI as a critical risk, while the Bletchley Declaration, signed by 28 countries, singled out cyber as one of the most concerning risks of frontier AI.

And top of the regulators list is data privacy and security. How are the AI players, who rely on harvesting intelligence from others' data, ensuring that they keep that intelligence safe?

Every CEO that I talk to - across all sectors, across the globe - wants to understand their own AI strategy across their business. How can they leverage it to make their business more efficient? For CEO's, AI is about operating leverage.

Every CISO that we talk to understands that security is a natural home for AI, where interrogating complex datasets at speed is part of the day job. Throw in the skills deficit, and this makes AI an essential, not a nice to have.

At the same time, these leaders are well aware that AI is already in the hands of adversaries who are exploiting AI for nefarious purposes. How can the good guys stay on the front foot?

This is one question to which we have an answer. That answer is give defenders the home turf advantage.

Slide 7
Over the last 10 years, you've heard us say time and time again that Darktrace AI is very different to many other AI systems out there. To understand that claim, is to understand the data that fuels our AI.

There are two approaches to data; broad and shallow, or narrow and deep. Let's look at the first.

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1 Markus Anderljung and Anton Korinek, 'Frontier AI Regulation: Safeguards Amid Rapid Progress,' *Lawfare media 2024*, https://www.lawfaremedia.org/article/frontier-ai-regulation-safeguards-amid-rapid-progress

By having access to vast datasets, many security systems harvest security insights from large populations. This is by far the most useful means of identifying and mitigating what we refer to as "known bads." When we talk about known bads, what we mean are threats that are identified via rules, signatures, trends, behaviour patterns, latest threat evolution intelligence, etc.

The more data – specifically, threat data – you have, the better you can identify known threats.

Consequently – what we're seeing at the moment is essentially a race to see who can get the most, and the most expansive dataset on the threats that exist today.

That race is between the biggest players in the industry – its why we're seeing so much M&A (eg Cisco + Splunk) and why other competitors are pushing hard on the idea of a platform (Palo Alto), to try and be expansive, collect as much data as possible, and be the best possible solution for identifying 'known bads'.

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It is certainly unusual for us to be spending a so much time talking about an approach that is not ours, and vendors that are not us, but I want to make one thing clear – we are not competing in this race.

We are not trying to look for known bad.

Slide 9
We fall into the second category; we use narrow and deep data. Instead of harvesting data from thousands of organisations, summarising it and taking it to the AI, we do the opposite. We leave the data where it is, and take our AI to the data.

Our AI learns from both native sources (e.g. Cloud, Email, OT, Identities, Endpoints, Network) and 3rd party sources like other vendor security tools (e.g. EDR tools, or M365 applications) - from *anywhere* across a digital business.

Just as your immune system understand 'self', and so can identify 'other', Darktrace learns the unique digital fingerprint of a business which means it can spot when something is out of character. This is the only approach that empowers you to spot the unknown unknowns.

But latterly, our most important evolution is that our platform approach provides proactive security - preemptive cyber defense which eliminates weaknesses across your people, process, and technology before they are used against you.

This approach only works by leveraging AI as a defensive tool to proactively identify internal and external vulnerabilities that are unique to your organization, to allow gaps in security policy and process to be identified *before* an attack occurs.

As Socrates said, "To know thyself is the beginning of wisdom."

Whilst I can't be certain that he had cybersecurity on his mind when he memorialised this phrase, it is an incredibly powerful philosophy in giving defenders the upper hand.

Slide 10
To give you just one of the thousands of examples of unknown unknowns we stop every single day – in January this year, critical vulnerabilities were disclosed in Ivanti Connect Secure (CS) and Ivanti Policy Secure (PS)

appliances. Vulnerabilities in internet-facing appliances are particularly dangerous, as they can provide a way to obtain unfettered access to an organization's internal systems.

With no prior knowledge or understanding of these vulnerabilities, Darktrace AI autonomously observed a surge in malicious activity targeting many customer's Ivanti appliances, and proactively helped to defend customers against the potential repercussions of this exploit.

Darktrace DETECT™ identified deviations that were indicative and generated a variety of model breaches (i.e, alerts) highlighting the suspicious activity. Darktrace's Cyber AI Analyst™ autonomously investigated the ongoing compromises and connected the individual model breaches, viewing them as related incidents rather than isolated events. When active and configured in autonomous response mode, Darktrace RESPOND™ contained attackers' operations by autonomously blocking suspicious patterns of network traffic as soon as they were identified by Darktrace DETECT.

In short:

1. Darktrace detected a threat never before seen in the customers environment, without any prior knowledge of the vulnerability.
2. Darktrace AI analysed it without a human in the loop, or any need for threat intelligence.
3. Darktrace stopped it from escalating into a crisis.

You can find out more information on this and other threats that Darktrace has thwarted by visiting the blog page on our website.

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So, should security be approached from the inside out, or the outside in? Is broad and shallow or deep and narrow the best approach?

We've established that broad and shallow is a great way to harvest intelligence on historic 'known bads', and that is not what we do.

We ourselves leverage AI internally to detect known bads in our own security stack – for us, our vendor of choice is Microsoft, with whom we have a deep technology and commercial partnership. Microsoft are the best in the world at detecting the known bads and this is no easy feat – it is expensive and hard work to make sure these data sets are up to date against the backdrop of new threats emerging each and every day.

What we focus on with our platform is defending organizations against the threats for which there are no data sets – those unknown unknowns – by empowering them with a unique understanding of themselves. This understanding also enables the technology to proactively harden a business at its weakest points to safeguard it against *future* threats.

Another philosophy also underpins our approach: you cannot *take a siloed approach to cyber security*.

Attackers don't think in siloes, so why should defenders?

Our AI works across identity, network, cloud, email, OT and many more environments. And we sit alongside the likes of Palo Alto, Crowdstrike, or a Microsoft in almost every single strategic deployment that we're in – fundamentally, we are better together.

Slide 12

But what about that CEO concern I started with; how do businesses best operationalise tools such as AI to provide operating leverage? Strategic AI partnership is exploring the human element of the security landscape, looking at how AI can be leveraged to augment the human at the centre of security operations - relieving them of labour-intensive and time-consuming tasks.

Many people believe that this is an area limited in scope, confined to certain subsets of AI such as large language models - like chatbots or automated suggestions - but it's actually much more sophisticated than that.

This is an area that we actually pioneered with the creation of our Cyber AI Analyst in 2019, a capability trained on our own human analysts to automate the process of triaging, investigating and analysing threats.

This technology is still evolving and developing but is increasingly able to integrate with other tools to enrich data and inform insights, and it's a technology that will work alongside and *augment* both the broad and shallow, and narrow and deep approaches to AI – not designed to replace or compete with them.

We see this kind of technology now being rolled out in solutions such as Microsoft's security copilot, augmenting the human at the centre of its operations, and it's something that we are looking at combining into parts of our own technology in the future.

I began by referencing the many questions that fall out of modern AI debates. Many of these questions are sparked by justified concern about how AI will alter human life as we know it, and how it may be used for nefarious purposes. I am fundamentally an AI optimist. I believe in a future where AI can make the world safer and where AI has a positive impact on how we live our lives. I also believe that AI is the only way to combat the potential threats of the technology. I believe in that future because it is already a reality in the cyber security industry.

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Lets turn our attention now to the business, and to the GTM changes that we have made over the course of the past year.

Throughout the latter half of 2023, under the cover of a slow macro environment, we made some significant changes to the GTM portion of the business. The changes we rolled out were not without disruption, but we knew that we could weather that disruption and reap benefits at the other side. We now have our heads down – firmly in execution mode, targeting for growth building throughout FY24 and beyond.

So, before we go into how that's going for us, lets recap on what exactly those changes were:

1.Phase one of these changes was preparatory. We transformed the segmentation and structure of our account teams, and changed who they target. Small, medium and large accounts now have dedicated teams with specific processes in place for each.

2. We also moved to a named account model, away from a less mature hunter-gatherer approach to new business, and those changes have been fully implemented.

3. AEs, customer success and technical presales now all report into the CRO function rather than being separated, and their workflows are more streamlined to ensure a more integrated customer-facing team.

4. We also introduced new methodology and training, such as MEDDPICC for approaching prospects and developing how we go about selling into these accounts.

5. We changed our commission structure to sit more in line with the rest of the industry, and to attract the best talent possible, particularly in the US region.

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We've said previously that these changes have stabilised, and that they're going well for us. But I want to go a little deeper into the results of these changes and how they're going.

Firstly, I'll start with our salesforce attrition. This is something that had been at a high level since covid, particularly in the US – however since we brought in the GTM changes, we're pleased to report that we have seen a significant decrease in salesforce attrition, especially in the US.

In fact, US account teams working on small – mid enterprise have also improved in terms of salesforce efficiency across all metrics, not just attrition. Our conversion rate in the region also rose, as more tenured salespeople followed a more disciplined process to pursue better targeted and qualified sales prospects.

As we have said in the past, the US remains our biggest market and deepest revenue opportunity, and we are pleased with the performance and progress of our US team as a whole.

Earlier this week, we announced that our Federal business has received a High Impact Level "In Process" designation from FedRAMP, meaning that our DETECT and email product are now listed in the FedRAMP marketplace, a hugely significant milestone for us on our journey to joining the highly exclusive list of vendors authorized for 'High Level Impact' selling into the Federal business.

Turning your attention to our upsell business – we know that this has always been a massive opportunity for us, but historically not one of our core focus areas. We spent a lot of effort implementing changes to the GTM function with the customer at the heart of our focus, with the intention of more easily upselling to our happy customers, and it is not a coincidence that we delivered one of our biggest upsell quarters in history in the second quarter of FY24, which was predominantly driven by this momentum.

We have also fully integrated workday into the finance and HR functions to give us better and more accurate data, and we will be rolling out Salesforce during our next fiscal year. What will follow is an implementation of new tools and solutions in other areas, such as new marketing technology in a full Martech stack.

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We are happy with the progress we have made on the changes made to date, and are starting to see the early rewards of those changes. But there are future benefits, those with longer cycles, that we are yet to see.

The first really big area is in our penetration of new strategic accounts, which remains a long-term goal of ours over time. As we head into spring, we are starting to see budding green shoots of improvement in this area, though it is not part of guidance for this financial year. Our FedRAMP certification is certainly a great step in securing strategic deals in the Federal space.

The second area that we expect to see meaningful improvement for us in is in the continued momentum of upsell motion. This is starting to deliver for us as I mentioned, and as our upsell and renewal rates improve, we should also in turn start to see our net dollar retention improve over time.

Our third key priority is the channel. We have been clear on our need to engage more with the channel, as there is a big opportunity here. Dan Monahan, our SVP of our partner organization, is continuing to build this out and forge meaningful relationships with both new and existing channel and distribution partners.

Recently, we strengthened our already close partnership with Microsoft, with them announcing Darktrace as one of just 8 independent software vendors they believe are at the cutting-edge of AI innovation. However, again, our channel program is not included in our guidance for FY24.

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I've spent some time talking about the improvements to our GTM function, but our ambitions for continuous improvement stretch across the entire business.

The first of our next phase of investments will focus on the marketing function. It is important to note that we expect these changes to be highly impactful, but with no disruption.

We will start with a global roadshow across more than 30 cities, focused on our product positioning and differentiation. This roadshow will consist of half-days packed full of content – keynotes from our marketing leadership, technical content, networking and meetings for our customers aligned to the new announcements we'll be making.

There will also be a virtual launch of this event on April 9, and we can share this link with those of you who are interested.

One key benefit you can expect from these branding and positioning changes is a clearer breakdown of our products and coverage areas.

An additional next phase of investment is evolving the product marketing team, to ensure we have the right interface with R+D and the marketing team, to professionalise the way we communicate the value of the product and its capabilities to the industry, in particular to technically-minded customers and industry professionals.

Lastly, we continue to make strategic investments, including significant senior key hires such as a new Chief People Officer, and internal enablement programs.

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As an AI and Cyber business, our R&D is our crown jewels.

In April 2023, we released an updated email product, which has driven a large amount of growth for us over the course of the year and remains one of our most popular products.

Four months later, we released our HEAL product, which marks the second product that we promised to the market at the time of IPO. Adoption is going well, and we expect to see acceleration as we progress through calendar year 24.

In October 2023 we released an upgrade to our cloud product, providing supercharged cloud-native threat detection and response capabilities to our customers. In addition, our PREVENT product that we released in summer 2022 continues to deliver success for us and is also a big driver of our growth, being adopted by organizations across the world.

The investment we have made in our business more broadly will also be reflected in our R+D department, building out the product management team to streamline and improve how customer feedback influences product development to maximise customer satisfaction and successfully capitalise on upsell opportunities.

Over time, we do expect to see our R+D to sales trend towards our midterm goal of 10-13% of revenue. However, this scale upwards in R+D investment will not be seen as unanticipated, nor will it drag on margins,

because we will be doing this at a time when we expect to see significant scale benefits in G+A and sales and marketing.

Now, over to Cathy to talk deeper about the financial performance.

Cathy Graham, CFO

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Thanks, Poppy. Today, I want to accomplish two things. First, I'm going to provide more context around our first half results, including the trajectory shift from first to second quarter. And second, I'll discuss our outlook for the rest of the year, with its increased expectations for revenue and adjusted EBITDA.

Over the past year, we ramped up investment in our Go-to Markets teams, and at the start of this financial year, made significant changes to the way those teams work and are compensated. We expected this would have an impact on first quarter performance, and it did, but happily, the teams adapted quickly and delivered a strong second quarter.

Slide 19 – Revenue, Subscription %, Rev by Geo

In our first half, revenue grew by 27.4% over the prior year period, and subscription contracts continued to make up more than 99% of that revenue. As we've said previously, we believe that the US is our largest untapped market, so a significant amount of our investment has been focused there. While it's too early to see significant movement – particularly given our subscription model – as a percent of total revenue, the US has grown by 4/10ths of a percentage point over the past year.

Slide 20 – ARR, Net ARR added

We focus on expanding constant currency ARR to drive top line growth. For most of FY 2023, our ability to grow ARR was dampened by the increasing impact that macro-economic headwinds had on new customer opportunities. In response, we shifted focus to increased upsell activity within our customer base, but are pleased that now, broader macro trends appear to have stabilized.

In that context, we delivered first half constant currency net ARR added of $64.8 million, (10.8)% below the prior year period, for year-over-year ARR growth of 24.4%. This year, however, it's important to look at the trend within our first half. As I said a moment ago, in July we made significant changes to the way our Go-to-Market teams work and are compensated. And, as expected, it disrupted first quarter sales activity. While first quarter net ARR added was down (21.6)% year-over-year, second quarter additions were down only (4.5)%. This gives us comfort that the first quarter impacts were indeed transitional and temporary, rather than the result of anything more systemic, and the trajectory between quarters supports our expectation for a return to growth in ARR additions in the second half.

Slide 21 - USD ARR, RPO

FX tailwinds in the first half saw ARR at reporting date US Dollar rates slightly outpace the comparable constant currency measure, growing by 26.3%.

RPO, or committed backlog, also in our US Dollar reporting currency, grew 12.2% year-over-year, noticeably less than related ARR growth. While a period of slower new customer sales, as well as the shift to upsells – which have generally shorter contracts terms to match initial contract expirations - were a contributing factor, they were not the primary driver of what should be a temporary disconnect.

The largest factor in slower RPO growth was that in 2021, a large cohort of contracts were signed in the late-COVID pent-up demand period, and given an average contract term of about 36 months, are starting to come up for renewal. As a result, the average contract life in RPO is currently significantly shorter than typical, and correspondingly, the average value is lower. As we move through the next year, and these contracts are renewed for more typical term lengths, the average duration of ARR in RPO should naturally increase, delivering an underlying increase in year-over-year RPO growth.

Slide 22 -Customers, Avg Contract ARR

Our ARR measures are driven by the addition of new customers and the upsell of new products and coverage expansions to our existing base. Year-over-year, we grew our customer base by 12.9%, adding 433 net new customers in the first half of the year.

Year-over-year, average contract ARR increased by 10.2% across our customer base. Given the shift of focus to upsells during the period, it's not surprising that this was driven by an increase in the average ARR of existing customer contracts, which was up 12.4%.

Slide 23- +/- $100k by customer and ARR

We continued to sell across a broad range of customer and contract sizes, however, consistent with the changes to our sales strategies and increase in average contract ARR, our account distribution has again shifted towards larger contracts. For the first half, 56.6% of ARR came from the 19.5% of customers with ARR of more than $100K, up from 52.2% of ARR from 16.7% of customers in the prior year period.

Slide 24 – Churn, N$RR

By the end of the first half, both our churn and Net ARR retention measures had largely returned to prior period levels, recovering from the minor erosion we saw at the end of FY 2023.

For churn, that FY 2023 erosion was driven by an increase in bankruptcies and other defaults, as customers across our base grappled with their own financial challenges. And, as you'd expect, that impact pulled through to Net ARR retention. Now that our second quarter performance has demonstrated stabilization in the broader environment and a continuation of positive upsell trends, we expect to start showing expansion in our ARR metrics driven by increased upsell and improving retention trends.

I'll caution you that with respect to net ARR retention, progress is likely to be gradual for the next 12 to 24 months before accelerating. This will not reflect in-period performance as much as it will the roll-through of prior period trends. In upcoming periods, churn – a key input to Net ARR retention - will be impacted by the pending renewal of that large cohort of contracts signed in the late-COVID pent-up demand period. This means that even at improved

renewal rates, the relative size of that cohort will dampen improvement in one-year churn and therefore, Net ARR retention as well.

Slide 25 –Adj EBIT and Adj EBITDA

So far, we've talked a lot about growth trends and drivers, but I want to make sure we also give the appropriate focus to our profitability measures. Year-over-year, we've driven significant improvements in Adjusted EBIT and Adjusted EBITDA margins, higher by 9.0 and 8.2 percentage points, respectively.

First half Adjusted EBIT increased by $38.5 million to $71.0 million, reflecting a 21.5% margin, and first half Adjusted EBITDA increased by a similar amount to $84.5 million, for a 25.6% margin. These increases resulted from continuing scale efficiencies and discretionary cost management, as well as an FX environment that was more favourable than in the prior year.

Just as a reminder, given our growth and investment patterns, Darktrace's first half profitability measures are usually above second half and full year results, so please see our guidance when considering your near-term expectations. Despite this, it is worth noting that with our long-term, steady state economic model aiming for a mid-20%s Adjusted EBIT margin, our profitability performance and trends now have that target clearly on the horizon.

Slide 26 – Summary P&L

As we've consistently demonstrated, Darktrace has a resilient business model, where multi-year contracts cushion revenue growth during periods of economic uncertainty, and high variable costs allow us to be responsive to profitability and cash flow goals. Within that framework, I'd like to spend a few minutes on some of the operating trends driving profitability, and how some of the changes being made in our Go-to-Market organization are resulting in FY 2024 and beyond cost classification changes you need to understand.

In Cost of Sales, our core direct cost model has remained largely unchanged. The slight reduction in gross margin between periods was due solely to an FY 2024 accounting policy change, where we are now allocating a portion of share-based payment and related tax charges to direct costs, proportionate to the labour costs in that line item.

The increase in Sales and Marketing expense between periods reflects the investment we've made in our Go-to-Market strategy over the past year, and that we believe will support the re-acceleration of ARR added growth we expect in the second half and beyond. While we'll continue to expand this function, we expect that most large functional investments have already been made, and we should see these costs scale more efficiently going forward.

Also note that some of the increase in Sales and Marketing expense has been the result of changing certain roles and responsibilities, including in our Channel Partner and Customer Success functions, to focus more on sales and less on operations. This has resulted in compensation costs that used to be attributed to G&A now moving to Sales and Marketing. I'll give you more details on that in a minute.

In aggregate, R&D costs have remained relatively similar to the prior year period. However, this includes the impact of accounting policies and requirements that mask what was a 15.3% increase in cash employment costs. In R&D, the timing of product development labour costs capitalized in the period vs the amortization of these costs capitalized in prior periods will often skew period-to-period comparisons in ways that will vary based on development cycle timing.

In G&A, while comparable underlying functional costs grew at around 20.5%, reported G&A expense declined in absolute dollar terms between periods. This was due in large part to a shift of costs to Sales and Marketing based on changes to certain roles and responsibilities made at the start of this financial year; more on this momentarily.

It's also worth reminding you that in FY 2023 and, to a lesser extent, the first half of FY 2024, G&A was reflecting the costs of implementing Workday as our new Financial and Human Capital Management platform. While we continue to have expenses to refine that system and do follow-on feature implementations, the phase down of Workday implementation costs has been largely offset with the phase up of costs to implement Salesforce as our new CRM tool. We expect to have these implementation costs through at least the remainder of this calendar year before we see a more lasting decline in implementation costs.

Finally, share based-payment and related tax charges have largely become normalized in the first half of FY 2024, after absorbing the cost of now fully expensed IPO-related grants in the prior year period. While this is most visible in G&A, which was carrying the bulk of that expense, this also explains most of the related cost decline in R&D. There was a similar decline in these costs for Sales and Marketing, but grants made as part of leadership hiring over the past year, more than offset any savings from the completion of IPO-related grant expensing.

Slide 27 – Impact of GTM changes

As I mentioned a moment ago, a significant portion of the increase in Sales and Marketing expense, and of the absolute decline in G&A costs, was due to changes in certain roles and responsibilities – and their related compensation measures – made as part of our larger Go-to Market transformation work.

In FY 2023, a significant number of Channel Partner and Customer Success positions had both sales and operational responsibilities. As importantly, the majority had separate compensation plans to incent those separate workstreams. Given this, in the FY 2023 period, we attributed the relevant compensation expense to either Sales and Marketing or G&A, based on the workstream.

As part of the FY 2024 Go-to-Market changes, these roles and responsibilities, as well as their associated compensation plans, were modified to be more commercially aligned. Based on this, all related compensation has been attributed to Sales and Marketing effective from 1 July 2023.

In this table, we have re-cast first half FY 2023 to show how Sales and Marketing and G&A would have been reported IF the roles, responsibilities, and compensation changes had been in place for that period. As you can see, about $13 million, or 38%, of the period-over-period increase in underlying Sales and Marketing expense was in fact due to the attribution change, rather than to true increases in operating costs. On this basis, underlying Sales and Marketing

expense would have decreased as a percent of revenue by 5.4 percentage points rather than by the 3/10ths of a percentage point shown in our reported numbers.

Conversely, on this basis, G&A costs would have shown the level of increase you'd expect given our Workday, Salesforce, and other infrastructure investments, and as a percent of revenue, would have decreased by 7/10ths of a percentage point rather than 5.7 percentage points shown in our reported numbers. In both cost categories, we believe this gives a truer representation of the level of underlying investment we are making, not only in our Go-to-Market strategy and teams, but in our operating infrastructure as well.

Slide 28 – Guidance

Today, we're confirming the guidance range for year-over-year constant currency ARR growth provided in our January Trading Update, where we narrowed our expected growth range to between 21.5% and 23.0%, therefore raising our midpoint expectation by approximately $1.6 million. This implies FY 2024 net ARR additions of between $137.0 million and $146.6 million, and year-over-year growth in Net ARR added of between (6)% and 1%.

Given continued strong ARR to revenue conversion and a relatively stable exchange rate environment, however, we are again shifting our revenue growth expectations upward by a half percentage point to between 23.5% and 25.0%. And as our first half profitability continued to demonstrate we can control discretionary spending without cutting back planned investment, we're also raising our FY 2024 guidance for Adjusted EBITDA margin to at least 21%, one percentage point above the top end of our prior range.

Further, while we're maintaining our expectation for Free Cash Flow at 50% to 60% of Adjusted EBITDA, note that this is now on an increased Adjusted EBITDA expectation. And remember that this year's lower than typical Free Cash Flow expectation is solely because of a transition in how we capitalize, expense and pay commissions that has us absorbing both current and prior period expense in FY 2024. We expect to return to higher, more typical levels after Q1 FY 2025.

So, in closing, we're pleased with our positive first half performance, and particularly with the strong second quarter rebound in sales performance and ARR added. We believe this shows that first quarter slowness was indeed the result of a temporary transition to new working patterns and structures, and that we're well set up to deliver the re-acceleration and positive year-over-year growth we're expecting for the second half. Our resilient business model once again showed that multi-year contracts and high variable cost structures do allow for continued growth, investment, profit expansion and cash flow, even in uncertain times. And, as we expect increasing benefit from recent Go-to-Market investments, we're looking forward to capturing more of what remains a large market opportunity, both in the second half of FY 24 and beyond.

And with that, back to Poppy for some final comments.

Poppy Gustafsson, CEO

Slide 29

In the midst of the AI spring, Darktrace has a very exciting opportunity ahead. Our AI technology is uniquely poised to give defenders the upper hand against attackers – regardless of what the next wave of threats looks like. At the same time, the strategic decisions we have made have started to surface meaningful progress.

As such, we are explicitly guided to a return to growth in net ARR added for 2H FY and we expect to build momentum through the calendar year.

We are not standing still – we do have more work to do, and we continue to work hard to build out the GTM and marketing changes that we have put in place. We hope to be able to give you all an update on these in our September results at the end of our fiscal year.

This movement back to growth should allow you to see some clear returns across sales and marketing, demonstrating the power of our overall economic model, as well as the power of our world-class technology.

Thank you for listening.

Slide 30 – thank you