EDITED TRANSCRIPT
FEYE - Q3 2014 FireEye Inc Earnings Call

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Good day ladies and gentlemen welcome to the FireEye third-quarter 2014 financial results conference call.

Kate Patterson - FireEye Inc - VP of IR

Thank you, Jonathan, good afternoon. Thank you for joining us on today's conference call to discuss FireEye's financial results for the third quarter of 2014. This call is being broadcast live over the Internet and can be accessed on the Investor Relations section of FireEye's website at investors.FireEye.com. With me on today's call are Dave DeWalt, FireEye's Chairman of the Board and Chief Executive Officer; and Michael Sheridan, Senior Vice President and Chief Financial Officer. After the market closed, FireEye issued a press release announcing the results for the third quarter of 2014.

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

These forward-looking statements involve a number of risks and uncertainties some of which are beyond our control which cause actual results to differ materially from those anticipated by these statements. These forward-looking statements apply as of today and you should not rely on them as representing our views in the future, and we undertake no obligation to update these statements after the call. For a detailed description of the risk and uncertainties please refer to our SEC filing as well as our earnings release posted a few moments ago on our website.
Dave DeWalt - FireEye Inc - Chairman & CEO

Okay Kate, thank you very much and good afternoon everybody thanks everyone for joining us on the call today were appreciate your continued support in FireEye. All right is now been almost exactly a year since hosted our first earnings call following our IPO in September 2013 since then we have scaled our business, expand our customer base and partner model, and significant built out our product line. We launched FireEye-as-a-Service offering, signed partnerships with three of the world's largest service providers expanded our operations worldwide. Through internal development and strategic acquisitions, we brought together the people, technologies and bright intelligence necessary to reimagine security.

In the process, we expend our market, extended our technology lead and created security company unlike any other. We come along way growing our business with our billings grown more than 10 times in less than three years. From $57 million in 2011, to an estimated $580 million in 2014. With that, I like to thank all of the FireEye employees for their dedication and focus on our mission. I believe that the best is yet to come.

So going back for a moment to January 2, 2014, that was when we announced the acquisition of Mandiant, we raise our guidance for 2014 revenue by more than 60% and provided a comprehensive financial model for the full year. I'm pleased to report that today, we have beat that model after nine months, and we expect to surpass nearly all major metrics for the full-year [2014]. More specifically in January 2014, we stated that we expected to obtain full-year billings of $540 million to $560 million and were now adjusting that full-year range to $573 million to $588 million, we more than doubled our billings every single quarter this year, and is the fifth consecutive quarter we raised our billings guidance.

We out performed against our original revenue guidance for the 2014 a $400 million to $410 million and now are expecting full year revenue guidance of $418 million to $430 million. In January, we expected non-GAAP loss per share of $2 to $2.20 for 2014 and we are now narrowing that range to $2.05 to $2.15. We also expect to add about 1,500 new customers this year and end year with more than 1,000 channel partners. All in all, we have consistently performed ahead of expectations and created a strong foundation for the future.

Moreover, I'm pleased to report that we met and exceeded each of our Q3 guidance metrics and demonstrated continue leverage in our financial model. Our Q3 billings performance of 45% sequential growth and 133% year-over-year growth was driven by broad demand across multiple industries and customers of all sizes and geographic regions. Because it's a significant in growing portion of our business is subscription based, we believe our billings are an important indicator of our growth. Billings drives our cash flow and our leading indicator of our future revenue growth.

Our revenues increased 168% year-over-year for Q3, and 171% for the nine-month period to date. Our products subscriptions revenue increased 133% as well. An increase in both the number and severity of advanced attacks is evidence in all aspects of our business. Our Incident Response teams operate around-the-clock responding to breaches and we remain active in a record number of engagements worldwide. From a threat intelligence standpoint discovered 2 more zero-days in Q3 bringing the total number of zero-days we discovered in the wild to 16. We also published new research on threat actors in Russia, China, and Middle East including a report on a group of Russian hackers we designated as APT28.

If you read our blog you'll see new posts on a daily basis detailing newly discovered threats and profiling the activities of different threat actors. We're now tracking more than 400 separate threat actors and order of magnitude increased from about 40 threat actors in 2009. Our threat intelligence is a key competitive differentiator and accelerates demand for our solutions. We believe that without this intelligence would be impossible to effectively detect today’s attacks.
From where I sit, the opportunity in cyber security has never been greater, the cyber threat landscape has never been more severe and the incumbent legacy security model has never been weaker. We estimate that over 90% of all organizations are breached and more and more companies are realizing the need new more adaptive security models. I believe FireEye has exactly that model.

Scott Borg who is the CEO of the United States Cyber Consequences Unit summed up the current state of cyber security well. When he said -- the most notable thing about these recent cyber breaches is not that they happen, but they went on so long without being detected. Companies are being blindsided because they’re not watching for the specific kinds of cyber attacks that are really going to hurt them. It’s clear that the signature in sandbox-based Defense-in-Depth Model, which are built on point product solutions including firewall, antivirus, IPS devices, web and email gateways, et cetera cannot detect today’s attacks and actually create more problems than they solve. These solutions which generate more than 100 false alerts for every actual threat create a burden on customer security organizations. That causes them to miss attacks, and probably more importantly present them from responding to attacks.

On the other hand, FireEye has 99% accuracy in our alerts Bottom line, companies spent over $20 billion annually in legacy products that did not provide the protection they need. At the time of IPO roadshow, we predicted the majority of these dollars will migrate to more effective security solutions. As awareness of advanced threats and attacks increase and customers realize they are unprotected. With announcements of new wide-scale breaches of nearly every day, I believe we reached the inflection point in the industry, and that is a technology market share leader in APT detections and advance security FireEye’s uniquely positioned as a trend to advanced security accelerates. This is reflected in our strong Q3 results.

Our billings of $165 million were up133% from a very strong third-quarter a year ago. And increased nearly 140% year-to-date. The underlying trend in our business suggest broad-based demand that stretches across both industries geographic regions and customer segments. So let me give you little more detail on our top line.

First of all, we closed a record number of transactions greater than $500,000 in value including 23 seven-figure deals compared with 11 million dollar deals in Q3 2013 and 7 last quarter. We closed large transactions with companies in a variety of vertical markets including technology or high-tech, financial services, retailers, health care and telecom, as well as US government agencies.

But the big deal are only part of the story, we expanded our install base by nearly 1,000 new customers with Q3 a year ago. Adding more than 100 new Global 2000 customers and more than 900 new customers smaller than the Global 2000. We doubled the number of mid-market and smaller customers compared to Q3 2013, providing again that it’s the value of intellectual property rather than the size of the organization that drives the purchase decision. Our reseller channel played an important role in our expansion beyond the large enterprise.

In our channel metrics continue to improve. The number of new partners increased from 127 in 2012 to nearly 1,000 -- actually 992 to be exact. And while, we still have work to do in order to realize leverage from our channel strategy, business with our top then partners increased more than 60% from year ago. Noticeably, deal registrations in Q3 increased by more than 40% sequentially, representing net new opportunities brought to FireEye by our channel partners. Not surprisingly given the breach environment, we added many new Incident Response customers as well.

The growth in our professional services billings, which are largely Incident Response services, reflects Mandiant reputations as the platinum standard in Incident Response. While IR represents less than 20% of our total billing is highly strategic. By owning a Response were closer to the breach giving us better threat intelligence, and establishing the trusted advisor relationship with our customers. Additionally, the conversion rate of Incident Response customers to other products is very high. Making this business an important source of leads and pipelines.

Turning to our products, in the last two months we extended our platform with several key product announcements and [interruptions] including support for Apple operating systems on our NX or web products and mobile platforms. We are now the only security vendor to detect threats targeting Microsoft, Apple, and Google environments. We also released the next generation of our IPS solution and introduced a our new Forensic and Analysis platform called the IA Series. The IA Series is based on technologies we acquired as a result of our nPulse acquisition and combines in-depth analytics with fast pack package capture and retrieval.
On the endpoint, we extended our endpoint response platform with a new release and add more than 1 million new production endpoint agents in the quarter. We now have more than 3 million endpoints installed making us the leader in next-generation endpoint security. Our HX Endpoint platform leverages the combined threat intelligence of both FireEye and Mandiant and is integrated with our NX Security Platform. As result, we can correlate detection and prevention between the endpoint and network parameters preventing further breaches at the perimeter as well as the lateral spread of malware given the network.

HX also includes our Agent Anywhere technology so security analysts can determine if an endpoint has been inspected and quarantined the threats even if the machine is not on the network. We are delivering this integrated endpoint network solution today, with advanced endpoint protection and forensics. In Q4 we expect the deliver next generation detection capabilities for the HX platform. Further extending our lead in this emerging market segment.

And finally, when combined with the next release of our Mobile Threat Prevention Platform including a new agent for android and iOS mobile devices we believe will deliver the most comprehensive endpoint platform in the industry. These product releases represent significant progress on our product roadmap. Extending our MVX engine into new attack vectors and expanding our technology leadership. They represents the first of what we expect to be many innovations to result from the combination of FireEye, Mandiant and nPulse.

In addition to the new products, we [want] launch the revolutionary FireEye-as-a-Service offering in September, FireEye-as-a-Service is uniquely positionied to help customers with the advanced threat landscape. The combination of our advanced detection virtual machines, our endpoint agent technology, our security experts, and our threat intelligence all wrapped in a single servers offer from the cloud enables companies to do with this problem much more effectively and at a lower cost than ever before.

Our fast service is proactive providing real-time sweeping and elimination of advanced malware every 60 minutes using [TAP] intelligence that has collected real-time from over 5 million virtual machines and 3 million endpoints in 60 countries, from the most important network in the worlds. Like our other security products FireEye-as-a-Service of 99% accuracy and less than 1% false positives we believe it will be a significant improvement over legacy security models. FireEye-as-a-Service billed as a subscription service reducing initial capital outlay compared with the more traditional purchasing model.

This built in flexibility helps to address budget issues making our technology more accessible to a larger number of customers and perhaps most importantly allows customers to fully leverage our security expert teams and visibility into threat environment. Depending on their in-house security resources customers can choose to have us manage their entire FireEye infrastructure or user expertise augment their own resources. We’re already managing hundreds of managed events where FireEye-as-a-Service customers from our operations and security centers around the world. We have capacity to manage hundreds more.

FireEye-as-a-Service of different from and complimentary to the compliance based managed security services you may familiar with the value proposition to the customer is very compelling. Additionally, because FireEye’s is a service complimentary to existing MSSP models it is creating new dissertation channels with the largest managed service providers. We recently announced Verizon, SingTel, and yesterday Deutsche Telekom as our first MSSP fees who will be offering these services to the customers.

SingTel will offer FireEye-as-a-Service to the entire Asia-Pacific region branded at SingTel managed defense powered by FireEye. The partnership presents the major investment by SingTel and FireEye security and includes security operations centers in Singapore and Sydney Australia as well as training and marketing programs throughout the region.

Verizon partnership is important as our first US-based MSSP, we believe validates our MVX Mobile Threat Prevention Platform. Under the first phase of this agreement Verizon is creating a managed mobile security offering based on our NTP product that will be offered as part of managed mobile security services suite. While it will take a few quarters before we operationalize these joint solutions, both partnerships represent a significant extension of our sales reach and increase the number of potential customers worldwide.

It’s been an exciting year, and I believe we have the early innings of our opportunity to finish up with you high-level thoughts. First, FireEye has always pursued a different vision from other security vendors, we pioneered the industry’s first virtual machine based detection engine and we
continue to expand our technology leadership as we introduced new products across the security landscape. With the acquisition of Mandiant and nPulse we extended beyond APT detection to offer new analytical and response capabilities integrated through our Adaptive Defense approach, a solution that can detect an attacks, tell the customer who attacked them, and what the attacker is likely to do next. This enables a proactive security posture.

When customer gets an alert, they have a [content] from the attacker with minutes and can block data exfiltration, determine which endpoints have been compromised, and contain to attack immediately. This is a powerful value proposition and its expanding our install base enabling new go to market strategies delivery models and strategic relationships.

When you think of FireEye’s business model in terms of subscriptions attach to boxes, I encourage you to change your frame of reference. Unlike firewall and other appliance center solutions hardware is not the primary driver of our growth. While I expect the sales of our appliances will continue to be important in growing part of our business, I believe if you think of us as a box vendor you will be underestimating the growth potential.

Q3 results illustrates this point. Our products billings grew 63% year-over-year while our products subscription billing grew 183%. Given our growing products subscription business, we believe billings for both product sales and subscriptions services is the best measure of our customer adoption of our technology. This metric increase 121% year-over-year, and we achieved in a [5,000] million run rate in billings.

So to summarize our future looks bright. Our market is growing and we have a strong differentiate solution. Demand reminds high as a threat environment escalate. And we’re well-positioned to lead the market, and strongly believe that no others vendors is capable of offering this combination of technology, threat intelligence, and expertise necessary to address today’s attacks.

So with that, I’ll turn the call over to Mike, for his comments on our financial model and I’ll conclude afterward.

Michael Sheridan - FireEye Inc - SVP & CFO

Thanks Dave. First I’d like to join Dave and thank you for your ongoing support and interest in FireEye. Before I begin, I would like to remind you that I will be discussing our non-GAAP financial results and metrics for the third quarter, specifically our reported non-GAAP results exclude stock-based compensation, the amortization of intangible assets, acquisition related cost restructuring charges, and nonrecurring tax benefits related to the Mandiant and nPulse acquisitions. Our 2014 non-GAAP also exclude changes in fair value of the preferred stock of warrant liability.

In terms of our financial results, I’d like to begin with a summary of our significant developments that occurred in the quarter. First, we continue to expand our business to a very rapid rate quarter with year-over-year quarterly billings growing at 133%, year-to-date billings growing at 138% and sequential billings growing at a very strong 45% over Q2. Similarly, we experienced year-over-year quarterly revenue growth at 168% year-to-date revenue growth at 171% and sequential revenue growth at 21% with a strong indicator given the [62%] of our business is subscription base. This growth occurred in all of our global regions and all of our market segments.

Second, we experienced rapid market adaption of our new products subscription offerings in the third quarter, in particular, we had strong positive reception from our customers to our FireEye-as-a-Service offering. FireEye’s uniquely positioned to deliver on the dock base consumption models compared to any competitors because of our unique proprietary threat intelligence that allows our experts to provide the highest level of rapid growth detection, assessment, and remediation available in the market today. We believe these offerings will be a key component to our continued expansion of our market share.

Third, as you know there many high-profile cyber breaches that occurred during the third quarter. Our Mandiant team of incident responders were on the frontline of addressing and resulting many of these breaches which enhance our Incident Response revenues. More importantly these engagements increased our pipeline of opportunities as these companies look to FireEye to deliver security solutions to address the shortcomings of the legacy firewall and other technologies.
And finally, you will not in my upcoming comments, that we made significant progress in the third quarter, in improving the leverage of our financial model, this impart relates to the rapid growth in billings and revenue I just summarize. But it also relates to the cost optimization we achieved in the third quarter. We successfully reduced cost inefficiencies in our Global headcount facilities primarily related to our acquisitions and we do so without reducing any of our focus on investment in our future growth. Will continue to further optimize our cost and drive growth going forward to continue down the path of profitability.

With respect to our Q3 financial results our billings grew to $165.1 million from $70.8 million and 133% increase year-over-year. There are several key drivers to the billings growth we achieved in the third quarter. First, we continued the rapid expansion of our customer base, our worldwide customer base grew to 2,761 customers in Q3 from 1,349 customers in Q3 of last year, 105% increase year-over-year and a 54% increase on a pro forma combined basis.

Our total billings growth was further driven by our business model that centers around recurring subscriptions and support. Our recurring subscription and support billings grew to $102.6 million from $41.5 million in Q3 of last year a 147% increase year-over-year. And a 93% increase on a pro forma combined basis. Our recurring subscription and support billings accounted for 62% of total billings in the third quarter. Historically, recurring subscriptions have been driven by a 100% attach rate of our suite of subscription and support to our product sales and this continued in Q3.

In addition, our FireEye-as-a-Service and Threat Analysis Platform subscriptions, continue to add growth to our recurring subscription business. Our product driven subscription and support contracts are paid 100% up front and are non-cancelable. In the third quarter of 2014 our average contract length for new orders was 34 months compared to 31 months in the third quarter of 2013. This increase related primarily due to federal contracts in the third quarter of 2014, both of which had five-year terms. Excluding these contracts our average contract length was 29 months.

Within total billings, our product and product subscription billings include the sales of our appliances, our DTI cloud subscriptions, our email URL engine subscriptions, and our continuous monitoring subscriptions. As well as subscriptions for FireEye-as-a-Service and Threat Analytics Platform. Our product and product subscription billings grew to [$116.1] million in Q3 from $52.5 million in Q3 of last year a 121% increase year-over-year.

Our combined renewal rate remained above 90% for Q3 which drove billings growth and is another indication of a high level of our customer satisfaction the value provided by our solutions. This rapid rate of growth in our billings continues to increase our visibility into future revenue streams. Our deferred revenues grew to $282.9 million in the third quarter a 51% year-to-date increase over deferred revenues of $187.5 million in Q4 of 2013.

Turning to revenues our total revenues grew to $114.2 million in the third quarter, which, was a 168% increase over $42.7 million in the third quarter of 2013. Our product and products subscriptions revenues grew to $81.1 million in Q3 of 2014 from $34.8 million in Q3 of 2013 and 133% year-over-year increase. On a pro forma combined basis, our product revenues, product subscription revenues, and combined product and product subscription revenues all grew at a rate in excess of 55%. Our customer support revenue grew to $14.2 million from $6.9 million in Q3 of the prior-year, a 105% increase. Our total subscriptions and supports revenue grew to $47 million in Q3 of 1204 from $18 million in Q3 of 2013 a 161% year-over-year increase. On a pro forma combined basis, our total subscription and support revenues grew at a rate in excess of 70%.

Our professional service revenue increased to $18.9 million in the third quarter of 2014 from $955,000 in Q3 of 2013. This increase is primarily related to the addition of Mandiant’s Incident Response business in 2014. In the third quarter, we experienced strong growth in our Incident Response organizations, as they were called upon to respond to many high-profile breaches that occurred during the quarter. Excluding professional services our geographic mix in Q3 included approximate 72% of our revenues coming from US accounts and 28% coming from international accounts compared to 71% and 29% respectively in Q3 of 2013. With significant revenue contribution from international regions is validating the investments we have made in these new markets.

Our product gross margins remained strong in Q3. As a percentage of product revenues our product gross margins were 74% in Q3 of 2014, compared to product gross margins of 71% Q3 of 2013 these strong product gross margins in the third quarter related to improved product discounts as well as better leverage in our manufacturing operations.
As a percentage of subscription services revenues, our gross margin was 69% in Q3 of 2014 compared to 72% in Q3 of 2013, this decrease relates to a higher revenues professional service revenues in Q3 of 2014 which had gross margins of 53%. Our total operating expenses increased $153.7 million in the third quarter of 2014 from $68.6 million in Q3 of last year. While we continue to increase our investment in R&D, sales and marketing, and global infrastructure, our operating expenses as a percentage of revenue decreased from 161% in Q3 of 2013 to 134% in Q3 of 2014. This decrease in part relates to the successful optimization of our costs model in Q3, we incurred approximate $2.8 million one-time charges related to these actions in Q3 and these charges are comprised primarily of severance cost and excess lease costs.

Each of our operating expense categories improve as a percentage of revenue Q3 of 2014 compared to Q3 of 2013 and most notably our investment in sales and marketing as a percentage of revenues decreased from 95% in Q3 of 2013 to 75% in Q3 of 2014. This improved leverage is resulting of the continuing expansion of our revenues in our domestic and international markets to the increasing productivity of our sales force as they ramp up in more highly leverage sales that we are generating in the middle market throughout insight sales reps.

In terms of our financial condition, we exited the third quarter with a proximally $398 million of cash and investments on hand. Our operating cash flow improve sequentially from negative $62 million in the second quarter to negative $46 million in the third quarter just ended. In addition, our pre-cash flow improve sequentially from $79 million negative in Q2 to negative $71 million in Q3.

Our account receivables increased to $156 million at the end of Q3, our aging and collection rates strong, this increase in receivables relates to higher billings in the quarter as well as a higher percentage of these billings occurring near the end of the quarter. Our inventory levels remain stable and we do not anticipate any issues with respect to excess or obsolete obsolescence in our stock. In terms of guidance for the fourth quarter of 2014, we expect our billings to be in the range of $195 million to $210 million. This results in a range of billings for the full year 2014 of $573 million to $580 million with a midpoint of $581 million, an increase from our previous issue guidance of $560 million to $580 million with the midpoint of $570 million.

With respect to our revenue guidance, we’ve experienced a rapid market adoption of our FireEye-as-a-Service offerings in particular in the third quarter. This is a very positive development for our business as it validates markets interest in these product offerings which further enhance our recurring subscription models, however, we recognize revenue for these product offerings rateably [versus] in-period. And as result this shift in mix affects the amount of in-period revenue generate from our billings. This impact can be seen in our Q3 results were we guided a range of revenues from $114 million to $117 million and reported revenue at the lower end of this range despite a billings result that exceeded our guidance range.

So far Q4, we expect our revenue to be in the range of $135 million to $147 million with the midpoint $141 million. This is a wider range of outcomes than our historical guidance ranges to allow for the impact of the evolving mix shift, this guidance translates into it annual guidance range of $418 million to $430 million for revenue with the midpoint of $424 million compared to our prior guidance of $423 million to $430 million with the midpoint of $426.5 million. We expect our Q4 gross margins to be in the range of 70% to 73%.

For operating expenses as a percentage of revenue in Q4, we expect R&D spending to fall in the range of 34% to 37%, sales and marketing expecting to fall in the range of 70% to 73% and G&A expecting to fall the range of 16% to 19%. Based upon our estimated weighted average shares of 144 million shares, we expect our loss per share in Q4 the fall within the range of $0.46 to $0.50 per share. This guidance for Q4 gross margin in operating expenses aligns with the prior annual guidance such that we reiterate our annual guidance for 2014 gross margins in the range of 69% to 72%, R&D spending in the range of 41% to 44%, sales and marketing spending in the range of 76% to 79%, and G&A spending in the range of 18% to 21%.

Excluding the impact of tax benefits related to the Mandiant and nPulse acquisitions, we expect record a tax provision of approximately $1.7 million to $2 million in the fourth quarter. Based upon our estimated weighted average shares outstanding of 142 million shares, we reiterate our expected loss per share in 2014 of $2.05 to $2.15 per share.

That completes my prepared comments, I will return the call to Dave for some closing comments and Q&A
Dave DeWalt - FireEye Inc - Chairman & CEO

All right thank you Mike. Before we turn it over for some Q&A a couple of last thoughts.

First of all, we had very strong quarter, we accelerated our momentum in this quarter obviously the growth rates year 133% year-over-year on billings, 168% year-over-year on revenue. When you look just at sequential -- 45% growth quarter over quarter in billings, 21% growth quarter over quarter in revenue, 74% gross margins, 23 deals over $1 million. Record number of contracts and customers for the Company, great momentum, great business, we're continuing to take the lead in this threat landscape. Obviously the MVX threat detection engine is really the hallmark of that coupled with our response framework FireEye-as-a-Service, I believe our investments in R&D are really accelerating the pace here in terms of our ability to execute and we are going to continue to do that.

So with that I like to the hand the call back over to Jonathan and Kate for some Q&A. And we'll go from there. Jonathan?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Daniel Ives, FBR Capital Markets

Jim Moore - FBR Capital Markets - Analyst

Thanks guys, it's actually for Jim Moore for Dan Ives, maybe if you can just talk a little bit about the puts and takes in guidance. What we might really expect around the services as we go forward just giving the shift in subscriptions and the transition there? And is it really happening at a faster pace then you would have expected or is it kind of in line with your expectations? Thanks.

Dave DeWalt - FireEye Inc - Chairman & CEO

Jim, I'll start, Mike feel free to add on here. No, we're seeing a fantastic acceleration, as I said, in the business. What has really been occurring here from a billings point of view is that we're seeing a mix change a bit. A lot of our customers love the combination of FireEye and Mandiant as a capability, and really when you take a step back, when customers have a breach or customers have an epiphany that they could be breached, you are finding them looking at a whole new model.

When they look at a whole new model they tend to look at the totality of our solution, which is what we call FireEye-as-a-Service, so we follow the subscription piece -- the product subscription piece really accelerates, and a lot of that is directly related to the breaches you are seeing everyday in the paper. We respond to those breaches. Those breaches are converting to products subscriptions, and its accelerating. So the mix change is happening. We think it’s a very strategic change that’s occurring. It allows us to be trusted advisors, it allows us to be stickier with the customer, perhaps more ratable in our revenue model, and as you can tell, we raised our guidance as well for billings going from the numbers of $540 million, $560 million at the beginning of the year, now $573 million to $588 million here for the full year, so we feel very bullish about the business and the model and obviously the performance, so any color there Mike?

Michael Sheridan - FireEye Inc - SVP & CFO

Yes. I would add a couple of things. I think first of all if you go back to the very beginning of the year when we guided the ranges of our revenue mix, we said that products would represent 40% to 45% of our mix. Year-to-date through the end of September, we're at 39%. We said that our subscription support revenues would represent 40% to 45%. We're at 43%. We said that professional services would be 15% to 17%, we're at 18%, so the visibility
that we had into the business at that time compared to our actual performance aligns very well. What we have seen, especially in our most recent quarter, is some of the consumption models that we offer, FireEye-as-a-Service, where our customers can access our technologies and our expertise in a subscription-based model, has outperformed our expectations. That’s a very positive for our business. So to be at a 39% instead of a 40% on the in-period product versus subscription-based product, for us we see as a very strong positive. That said, we have a model that has some elements to it that on a predictability basis for exact in-period performance for revenue a little more complex than other models out there, and we feel very good about the predictability of the business so far through the third quarter.

Dave DeWalt - FireEye Inc - Chairman & CEO

Last comment just there, Jim, for you, it’s the power of FireEye now. When you look at our go-to-market motions, we have a product led motion that has a number of subscriptions behind the core product. Typically that product was either or web or email product, behind that now we have quite a few subscriptions that we sell as a part of that. It’s our threat intelligence. Now our advanced threat intelligence, our IPS solutions, our continuous monitoring solutions, so we have a lot of blades, if you will, of subscriptions behind our core product led model that’s driving the mix towards product subscriptions, and then conversely, we have a service led model that’s largely Mandiant’s model, which drives from an IR engagement, or instant response engagement, instead of converting to product in-period, we’re now converting to product subscriptions, again creating more leverage for the Company over a period of time.

But those changes is really, I think, a pretty positive sign because you’re seeing that this old model of buying premise-based kinds of securities changing to new model, and we think we’re pretty uniquely positioned with FireEye-as-a-Service, with our subscriptions capabilities, and obviously you see that reflected in our billings growth and raising those numbers.

Michael Sheridan - FireEye Inc - SVP & CFO

Thanks good question next question

Operator

Gur Talpaz, Stifel.

Gur Talpaz - Stifel Nicolaus - Analyst

Thank you. So you [queued] billings by $10 million in the quarter, yet revenue kind of came at the low end of guide. You talked a fair about this, but it seems like most of it is really due to the strong adoption of FireEye-as-a-Service and the deferred nature of those revenues. My question is how do you maintain the traditional sales model with these customers that adopted FireEye-as-a-Service, do you think you would have exceeded your revenue guidance for the quarter?

Dave DeWalt - FireEye Inc - Chairman & CEO

I think that we had product subscriptions that were ratable compared to in-period products that absolutely would have -- remember the revenues that we reported were in the range that I had guided, and, yes, certainly the small differential from midpoint there was plenty of product subscriptions that would have otherwise been in-period that would have accounted for that gap.

Gur Talpaz - Stifel Nicolaus - Analyst

Got it. And with regard to your salesforce, do you incentivize them to sell one way or another? Are they given an incentive to sell FireEye-as-a-Service or do they have free will on how they approach their customers?
Dave DeWalt - FireEye Inc - Chairman & CEO

Gur, we really don’t differentiate from one product to another. Obviously, now we have our whole series of FireEye products and now rebranded Mandiant products under FireEye’s label. We don’t differentiate, quite frankly, a dollar’s a dollar for any of them, and that’s a good thing in a lot of ways because it allows us is to adapt and be agile in terms with the customer is requesting from us, and again, we’re seeing a shift towards more of a cloud-based model, more of a subscription based model. It’s not severe, it’s just that they we’re watching that each quarter try to move in that direction, particularly in the Mandiant portion of the business where we’re seeing incident response convert to product subscription versus an in-period product.

And that’s largely the difference you are seeing is that model, service led, converting to subscriptions not product, which is great, because we’re getting longer-term contracts more stickiness with the subscriptions and things, and I think efficiency is actually quite good with that salesforce and that model.

Gur Talpaz - Stifel Nicolaus - Analyst

Got it. One last product question. Can you talk about the customer interest level in the new endpoint offerings set to come out in Q4? Thank you.

Dave DeWalt - FireEye Inc - Chairman & CEO

Yes, Gur, we’ve been really gaining momentum and I think this is a strong area for the Company. If you look at when Mandiant was acquired we had an endpoint platform which was a critical element to our decision to acquire it. It was largely based on some new features in the endpoint landscape that hadn’t been seen before. Things like validating malware, containing malware, searching for malware, being able to remediate malware, and now what we are doing is adding more capabilities around that including detection and ultimately prevention on the endpoint.

We’ve now combined some of the Mandiant offerings with our mobile threat endpoint solution, which we’ve now added not just the Android platform, but now the Apple platform, so we have a very comprehensive solution that allows us to look at all endpoints across an entire architecture, be able to do things and respond to malware like no other. We now have all the mobility capabilities and soon to be able to detection. And you’re seeing every day when we walk into IR engagements we load that endpoint, we search for malware, it’s highly effective, we convert those engagements to endpoint sales. So our model is pretty powerful and you saw some of the numbers. Over 1 million new endpoints this past quarter added to our customer base and of course the number of customers and the size of those customers is very very strong.

So we like that platform, we are growing that platform out. I think we’re pretty uniquely positioned on the endpoint as we go into 2015. Thank you.

Operator

Brent Thill, UBS

Brent Thill - UBS - Analyst

Thanks. Mike, the DSO had a major jump, and I know you mentioned the billings happened later in the quarter. It just seems like a number of the security vendors had a much more linear quarter, but your talking about having a much more back-end loaded quarter. Was that related to some of the sales changes that you made, or are there other factors at play here?
Michael Sheridan - FireEye Inc - SVP & CFO

First, Brent, I would say that if you look at your DSOs quarter-over-quarter I think they’re pretty flat actually. The back-end loaded nature of our quarter primarily has to do with the fact that we’re selling into the enterprise and I think it’s a pretty typical element of most enterprise software companies and their sales model.

The aging of our receivables remains extremely strong. Very little, if any, write-offs, so the high credit worthiness of the customers into which we are selling remains very stable and a it’s a timing issue. We spent a lot of time trying to figure out how to improve that linearity. I think that some of those techniques are starting to show some promise, but to be clear, I think from a DSO standpoint, that the business has been pretty stable.

Brent Thill - UBS - Analyst

Okay. And just back to the migration to a service. The reduction in the guidance for the full-year -- I would assume that is predominantly -- given the ship, there’s no other things that you are seeing in the business that you’re concerned about that you would take revenue lower, and the follow on to that is, for Dave, how over time do you expect as a mix shift of the overall business, what percent as a service is going to occupy because it’s obviously going to have a lot of ramifications for all of our models as we look out the next couple of quarters?

Kate Patterson - FireEye Inc - VP of IR

Thank you. Hi, its Kate, we are sorry about that disconnect there. Brent if you would like to finish your question?

Brent Thill - UBS - Analyst

Yes, the question was just the migration as a service and how you think that will progress over the next couple of quarters, and Mike, I would assume that in the fourth quarter guidance you basically took down the guide for all of the transformation as a service rather than any other weakness you are seeing in the core business?

Michael Sheridan - FireEye Inc - SVP & CFO

I’ll start with an answer to that. Brent, yes, we came out of Q3 feeling that the business performed very strongly and we feel the same about Q4 and that’s why we’re raising our billings guidance. The change in the revenue mix has to do with the fast adoption of our FireEye-as-a-Service subscription offerings, and that really is the key to the change.

Brent Thill - UBS - Analyst

Great. Thanks.

Dave DeWalt - FireEye Inc - Chairman & CEO

Brent, this is Dave, just to follow on there, I just want to make sure it’s clear for you and for everybody. You just have to understand the way the service model is working because when we do an incident response, and I’m sure you all have seen, there’s a whole lot of breaches happening right now, and a lot of large companies, but we’re in the middle of most of those large engagements. What once was a service model that had an incident response that converted to in-period product is migrating. It’s changing, and it’s changing to a service.

It’s changing to what Mandiant and I call the managed defense service, but now that we put FireEye technology into there we call it FireEye-as-a-Service. So what we’re finding is the conversion from service model to product is changing to service model to products subscription. That, in essence, is the core of what’s happening and the more IR engagements we get involved with, the more compromise assessments we do,
the more that shift of product to product subscription occurs. And again, in a good way because they're signing up for a bigger version of our solution.

Not just what once was Mandiant managed defense, but now the totality of FireEye product together with the managed defense solutions. And this is what we're building out with SingTel, we're building out with the other service providers, so we see more of that coming in terms of customer adoption, more opportunity there, and you're seeing that a little bit in Q4's guidance, but at the same time we think it opens up a lot more markets, a little more sticky for all of the reasons we said.

I just wanted to make sure that was clear just so you heard that, that's the primary shift we're seeing. Next question?

Operator
Rick Sherlund, Nomura.

Rick Sherlund - Nomura Asset Management - Analyst
Can you touch on the status of the IPS solution? Is that selling well in the market now or are there still things that you need to do before you expect that product to gain a lot more traction, and maybe you could chat a little bit as well as about do you need to push more into the mid-market, and are you happy with the channel progress that you've had trying to reach down market a bit? Thank you.

Dave DeWalt - FireEye Inc - Chairman & CEO
Sure, Rick. A couple of comments there, Mike feel free to add on. A couple of things. IPS is doing well. We're finding a real opportunity largely because signature-based solutions are pretty ineffective right now against the types of attacks that are breaching all the companies. And we've created a much more cost-effective model to do some signature solution coupled with our virtual machine. So we've seen some good adoption of those combined capabilities. That's been very positive. This is our first full quarter now of having that product production, and as you can probably tell, we had some very strong adoption of that NX platform in this particular quarter.

So that's also a good segue because you mentioned the mid-market, obviously, offering these capabilities, both virtual machine, plus the IPS, plus now nPulse, and we had a nice nPulse quarter as well. You kind of see a combination there that now enables us to continue to cross-sell or land and expand with our core platform. And the channel has taken up well.

We have really expanded. We're up to 992 partners, as I mentioned, this is up from 127 in 2012. We had 43% growth sequentially in deal registrations, over $150 million of pipeline created quarter-over-quarter just from the channel, and that's kind of the traditional model selling. Now with FireEye-as-a-Service model where we're getting MSSPs engaged actually gives us an opportunity in 2015 to do even better with the channel with the partnerships like SingTel, Verizon, Deutsche Telekom and others, so we're working hard on that channel. Working hard getting leverage, and so far so good. The metrics look positive. Good question.

Michael Sheridan - FireEye Inc - SVP & CFO
Yes, Rick, I would add that if you look at our performance in the middle market, it's a good question because it's a very important part of our growth. We're doing very well in the middle market, as you know, our inside sales reps globally are our primary go-to-market strategy for succeeding in the middle markets, and if you look at our growth on a bookings basis in that segment of the market we believe we're taking significant market share.
Hi guys, it's [Sackett] on for Raimo. Thanks for taking my questions. First one for Mike, Mike can you remind us how the collections work for some of the different product subscriptions like FireEye-as-a-Service, and then similarly, how do the margins on a product subscription sort of differ then the product business?

So first on collections, all of our contracts are billed and collected upfront on a non-cancelable basis.

As you know, we sell typically, in our attach rate products with our appliances, 1 and 3 years subscriptions with a couple exceptions in Q3 where we sold some Fed contracts at 5-year subscriptions, but all of those are billed and collected upfront. FireEye-as-a-Service subscription, those are also billed and collected upfront on a non-cancelable basis, and so that part of our business model extends right into all of these product subscriptions. From a margin standpoint, we think that the margins in our FireEye-as-a-Service and those product subscriptions remains very attractive and very consistent with our current financial model. I guided gross margins for 2014 in the range of 69% to 72%, our long-term target model is 75% to 80% gross margins, and we think that these products are very well aligned with that model.

Got it. And then for my follow-up -- a quick question for Dave. Dave, you talked about FireEye-as-a-Service being complementary to the MSSPs. Can you just talk about that versus -- actually it maybe sounded a little competitive, so I was just a little confused on that. And then just along the competitive landscape question -- does FireEye-as-a-Service does it change the competitive landscape at all is really the question? Thank you.

It's a good question because at first level you might think that, but in reality, it's not really the case.

You have to remember what the legacy model is for a lot of the managed security providers. And that model is largely using kind of a SIM or a security information event manager to collect alerts off of a network or off endpoints. You tend to look at the SIM for information to determine whether or not something is occurring. And the reality of that model is it's not working very well. We're seeing all the breaches that you're seeing. A lot of these devices now are falsing at 99% rates. They have very very high alerting. Sometimes in the millions of alerts. And what happens, which was documented pretty heavily at Target during their retail breach there, was they just got overwhelmed by alerts and had a hard time seeing the true positives that were occurring from a FireEye type of appliance from all the other alerting that's coming out. So what you end up seeing here is a little bit of a shift that's happening. Not only is the customer asking for a different model saying, instead of looking at all these false alerts through a SIM, and perhaps engaging a contract with an MSSP to look at alerts, they're flipping it around and saying let's look at a more proactive more adaptive model. Maybe we start to do sweeping, we start searching and hunting for malware and we start turning around that proposition.
So one MSSP at a time is looking at that model saying instead of being reactionary perhaps we could augment that with something proactive, and that proactive model comes from FireEye-as-a-Service. And, like I said, we've signed up a few of these already. I think they're seeing it. It's a very powerful model and plug-in to what they're currently doing. So it kind of creates a best of both worlds kind of detection and prevention coupled with compliance.

Each side offers some solution and by the size of investment -- $50 million that SingTel is putting into this, you can see the power of that in terms of our opportunity to drive and leverage their type of model in the Asian market. So I think you will you see more of this, and I think you will see the MSSP model slowly shift from a reactionary model to a pretty proactive model, and you will see FireEye at the heart of a lot of that. So that's what we're showing, and I think you will see a lack of competition there as most of these vendors move to a new model or an augmented model.

Unidentified Participant - - Analyst
Thank you very much.

Dave DeWalt - FireEye Inc - Chairman & CEO
Thank you.

Kate Patterson - FireEye Inc - VP of IR
Next question please?

Operator
Gregg Moskowitz, Cowen & Company

Gregg Moskowitz - Cowen and Company - Analyst
Thank you very much. Just had a couple questions first either for Dave on Mike. Just so we're clear on the net effect, because I think there is a little confusion, or at least uncertainty, can you give us a sense of what the average financial impact is on both billings and on revenue if a customer buys FireEye-as-a-Service in lieu of an appliance?

Dave DeWalt - FireEye Inc - Chairman & CEO
The average financial impact, whether they buy on prem versus a subscription as a service? What's the difference? Is that the question you are asking?

Gregg Moskowitz - Cowen and Company - Analyst
That's right, Dave.
Dave DeWalt - FireEye Inc - Chairman & CEO

It all depends on the size customer, but generally it's very similar. If anything we're actually seeing larger contracts with the FireEye-as-Service. And remember, again, a lot of those are coming in in the incident responding model where they had a breach, they had an epiphany that there was a major problem with their current architecture, that's converting to a pretty large contract for FireEye-as-a-Service.

So, if anything, we actually see larger contracts with that so far, but know that we're now bringing them down market too with some of our partnerships, so I think in the end, the defense and depth model where you just add boxes to the problem, and hopefully that continues, because we are participating in that as well, or going to a security-as-a-service model, eventually I think you'll see a cost neutral there as customers look at both options and decide which to do.

I think the difference is, is there a breach, was there something publicly disclosed, how big of an impact did it have on the company, and what is really encouraging here, at least for us and our model, the more the impact, the more the education, the more they realize that old model is not working and there is a new model that's better and more efficient and perhaps even more cost efficient than the old model, and that's where we're seeing the adoptions.

Gregg Moskowitz - Cowen and Company - Analyst

Okay, so that's helpful, Dave. So effectively it's, obviously it's a revenue drawdown, but it sounds as though it's, if anything, a modest net billings uplift?

Dave DeWalt - FireEye Inc - Chairman & CEO

Yes, on a bookings basis, thus far it's been very positive just because of the larger contract sizes. And we hope that continues, obviously, but we are going to be offering this all over the world now. We've now built security operation centers in Dublin, Ireland, we've built two in the United States, one in Singapore, we're building another one in Sydney, Australia as part of the SingTel partnership, so we're going global with it. We are going down market with it.

And this utility, much like you think of like, I don't know, home security like ADT for your home, you come in and instrument your home, smoke alarms, sensors, things like that, and then it's monitored from a cloud, from a service center, we're doing the same thing and we are very proactive with the model of all the intelligence that we gather. It's really really a powerful model change that we're seeing, and I think over time you'll see more adoption of this, particularly as we get partner, so pretty positive. Yes, Mike?

Michael Sheridan - FireEye Inc - SVP & CFO

Gregg, one thing I would add to that is over a customers life the value of these FireEye service engagements are subjected to renewal opportunities for us, so that's another positive for the model.

Gregg Moskowitz - Cowen and Company - Analyst

Right, and then if I can ask just a quick follow-up, Mike? This was the first quarter in which net headcount was virtually flat and I'm wondering if you could just comment on hiring this quarter? How it compared with what you had expected heading into the quarter, as well as what we should look for going forward? Thank you.
Michael Sheridan - FireEye Inc - SVP & CFO

Yes, so the flatness of the headcount, as you know, we did go through some cost optimization work and some restructuring in the third quarter that affected that headcount, so you are looking at a net number. I would say the following; we hired well over 100 people in the quarter, our focus remains on growth across the business in particular in areas of sales, so that blended flatness you have to factor in both the reductions and the additions together. That has netted out.

Gregg Moskowitz - Cowen and Company - Analyst

Great. Thank you.

Kate Patterson - FireEye Inc - VP of IR

Next question please

Operator

Sterling Auty, JP Morgan.

Sterling Auty - JPMorgan - Analyst

Thanks. Hi guys. I think Gregg was going down the right path here. I think the feedback I'm getting from investors is they get the rateable recognition, the impact to revenue with the model shift, but where everybody is pinpointing is the fourth quarter billings guidance. I know you raised the full-year. You blew out the third quarter, and you're talking very positively, but the overwhelming feedback I'm getting is, I look at that fourth quarter guide and it looks like you guided down on billings.

That's why we're all looking for whether subscription has maybe, on an apples-to-apples, a lower contributions to billings because you don't have the hardware component, or did you pull forward deals in the third quarter? People are really just trying to gauge what the message is with the fourth quarter billings guidance specifically.

Dave DeWalt - FireEye Inc - Chairman & CEO

Yes, Sterling, again, I wouldn’t read into it as much as maybe I just heard there. We're obviously positive about the year. Positive about the growth that we're seeing. I think were just trying to make sure we've got a good number there that we can achieve.

And at the same time, be conscious about the mix change that we're seeing in our business. But we did have some good strong Q3. We are factoring that in as we look at Q4, and the combination of the second half -- when you look at what we came out of Q2 and what we guided to for Q3 and Q4, that number is consistent and up, so when you just look at it in parts we feel good. Anything you wanted to add, Mike?

Michael Sheridan - FireEye Inc - SVP & CFO

I think just at the highest level last quarter we guided $560 million to $580 million on the year, we are now guiding $573 million to $580 million on the year, so that certainly is not a reduction. I think if you just simply assume that all of the outperformance in Q3 gets back to the end of the guidance, that's not the right way to think about it either. Of course, we forecast the second half and you can have some positive timing on certain transactions and so forth that affect it to a minor degree, but overall, I think the message on billings is we raised the guidance and we're feeling very good about Q4.
Sterling Auty - JPMorgan - Analyst

All right. And one question in a different area. You talked about over 90% renewal rate, but can you just give us a sense of as you're going through those renewal transactions, what is the upsell/cross-sell? I didn't quite -- if you can characterize that for me that would be great.

Michael Sheridan - FireEye Inc - SVP & CFO

So I would tell you, Sterling, the statistic that we quote is the customer base statistic. The much more conservative one. If you were to look at a dollar base renewal and were to factor in cross-sales and up-sales, it is a significantly higher number. We have a lot of success in going back to customers in the renewal cycle.

With upsells, we don't publish what those results are, but the way we want you to understand the renewals in our businesses is that the numbers we provide to you are the most conservative posture we can take on it. We have extremely strong renewal base in our business and that continued in Q3.

Sterling Auty - JPMorgan - Analyst

All right. Thank you, guys.

Dave DeWalt - FireEye Inc - Chairman & CEO

One more question?

Operator

Jonathan Ho, William Blair.

Jonathan Ho - William Blair & Company - Analyst

Hi guys. I just wanted to get a sense from you -- I don't want to beat this to death, but basically what percentage of the new customers elected SaaS this quarter, and where do you see that number headed as we think about the impact to the models? That would perhaps be helpful in terms of just forward modeling.

Dave DeWalt - FireEye Inc - Chairman & CEO

We haven't given out a percentage of which renew customers are buying premise versus subscription - our product subscription, but I will give you this, and I think this is the most important element, it's in that service led area that you see a pretty large shift from what once was in-period revenue related to the Mandiant product to now Mandiant Defense or FireEyes-as-a-Service as we bring it all together.

Most of the conversions from incident response or service [litigations] are tripping into a large subscription kind of model for us, and that is a big part of the shift. Now we're also getting a lot more add on sales to FireEye's model where our core product is driving subscriptions behind it in the form of a number of other capabilities like a lot of our threat intel and some of our other services, so it's a little bit of a combination, but the majority of the customers buying post IR are now driving into product subscriptions.

That's the biggest percentage change and that is a majority kind of number, or greater, just to give you a sense, whereas a year ago that was a much smaller percentage.
Michael Sheridan - FireEye Inc - SVP & CFO

And I would add, Jonathan, if you looked at Q3, and you looked at our revenue guidance, we had ranged it at $114 million to $117 million. We came in on the lower end of that at $114 million, but we were within the range and so this effective we’re talking about in Q3 had a $1 million to $2 million differential in our modeling, so what we’re looking at in Q4 is we’re seeing just a significant uptick in customer interest in these consumption models for our product, and so we’re trying to factor that in to the outlook for Q4 as we talked about before with the billings going up and trying to factor this mix in. So we’re not giving out the exact percentages of how -- which customers are taking which format, but we believe that we’re analyzing the data correctly to try to capture these trends.

Jonathan Ho - William Blair & Company - Analyst

Got it. I just had one follow-up question which was is the SaaS model actually making it easier because the customers to buy or to consume using this model and therefore maybe bypass some of the upfront mix expenses associated with an appliance?

Dave DeWalt - FireEye Inc - Chairman & CEO

Absolutely that’s happening, Jonathan, because what’s occurring there is you have options now between CapEx and OpEx to use. And, as you know, there’s a bit of a shortage of experts in the security industry. They are looking to augment their staff or even have us run a lot of it for them.

They’re using combinations of budget from CapEx or OpEx to purchase, and being able to flexible when delivering a solution to a customer is required here. Especially in these security breach environments. Sometimes they have the money in one area, sometimes the other, or a combination of the two. We’re a provider now, as a Company, who can deliver any of those models or combinations of those models to our customer. So I think it’s a powerful strategic advantage against our competition.

Not only with the people in the product and the intelligence together, but also the form factors they can buy from CapEx or OpEx for us. So it creates unique capability that we now can do. So thank you.

Okay, with that I would like to say thank you for joining us today on our third-quarter earnings call. As Kate said at the beginning, we’re at a number of conferences coming up, the Wells Fargo Conference, the UBS Conference, the NASDAQ conferences, Mike and I will be at a few of those, so look forward to meeting everybody, and thanks very much. Take care.

Operator

Thank you, ladies and gentlemen, for your participation in today’s conference. This does conclude the program. You may now disconnect. Good day.