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Q1 2024 Cellebrite DI Ltd Earnings Call

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PRESENTATION

Operator

Welcome to the Cellebrite first-quarter 2024 financial results conference call. (Operator Instructions) I would now like to turn the call over to your first speaker today, Mr. Andrew Kramer. Mr. Kramer, the floor is yours.

Andrew Kramer ***Cellebrite DI Ltd - Vice President, Investor Relations***

Thank you very much, Leo. Good morning, good afternoon. Welcome to Cellebrite's first-quarter 2024 financial results conference call. Joining me today from just outside of Tel Aviv, are Yossi Carmil Cellebrite's CEO; and Dana Gerner, Cellebrite's CFO.

There is a slide presentation that accompanies our prepared remarks. Please advance the slides in the webcast viewer to follow our commentary, we will call out the slide number we are referring to in our remarks. This call is being recorded and a replay of the recording will be made available on our website shortly after the call.

Starting with slide number 2, a copy of today's press release and financial statements, including GAAP to non-GAAP reconciliations, slide presentation, and the quarterly financial tables and supplemental historical financial information for the first quarter of 2024 of each quarter of 2023 and 2022 are available on the Investor Relations website at investors.cellebrite.com.

Also, unless stated otherwise, our discussion for the first quarter 2022 -- sorry, 2024 financial metrics as well as the financial metrics provided in our outlook, will be done on a non-GAAP basis only and all historical comparisons are with the first quarter of 2023, unless otherwise noted. In addition, please note that the statements made during this call that are not statements of historical fact constitute forward-looking statements.

All forward-looking statements are subject to risks and uncertainties and other factors that could cause matters expressed or implied by those forward-looking statements not to occur. They could also cause the actual results to differ materially from historical results and or from forecasts. Some of these forward-looking statements are discussed under the heading Risk Factors and elsewhere in the company's annual report on Form 20-F filed with the SEC on March 21, 2024, and as amended on April 12, 2024. The company does not undertake to update any forward-looking statements to reflect future events or circumstances.

Slide number 3 provides the agenda for today's call. And as you'll hear we started 2024 off on a positive note with another very solid quarter. We moved forward with good momentum and are excited about the opportunities we see ahead to further expand our business this year. With that said, I'd like to turn the call over to Yossi Carmil, Cellebrite's CEO.

Yossi Carmil ***Cellebrite DI Ltd - Chief Executive Officer, Director***

Thank you, Andrew, and thank you all for joining us today. The financial results highlighted on slide 4 demonstrate that Cellebrite is off to a very solid start in 2024. We delivered a strong first quarter performance anchored by the further expansion of our business, improved profitability compared with the same quarter of one year ago, and meaningful strategic progress.

As I say, it is rewarding to see our solutions are making a tangible difference in accelerating justice around the world. And while I plan to share more about the market opportunity, our strategy, our achievements, and our outlook, I would like to turn now to slide 4 to briefly recap our Q1 results and selected KPIs.

And more specifically, ARR grew 27% to $331.8 million. We continue to see strong ARR growth globally. And our Q1 ARR expansion is primarily driven by our success in expanding existing customers' relationships, which is consistent with historical trends. The total revenue of $89.6 million increased 26% on the strength of a 29% increase in subscription software revenue. Adjusted EBITDA was $17.6 million or 20% on a margin basis, and we reported non-GAAP earnings per share of $0.08. We also ended the first quarter with cash, deposits, and investments totaling approximately $347 million, a $15.5 million increase since the end of 2023. Of the trailing 12 months, our ARR growth rates and adjusted EBITDA margin trended above the baseline target of Rule of 45.

Turning to slide 5. As most of you know, Cellebrite hosted its first ever Investor Day in late March this year. And this was a great opportunity to provide our analysts and shareholders with a deeper dive into our business and our bright future. During this event, we highlighted the underlying trends, Cellebrite's overarching strategy, our compelling Case-to-Closure platform and flagship solutions, as well as key technology and go-to-market initiatives that will enable us to convert meaningful ARR and revenue growth into further improvements in adjusted EBITDA. And we expect that our ARR and top-line expansion over the coming years will continue to primarily come from further expansion within our installed base of customers.

Now I'd like to explain why we are so bullish on this opportunity. So first, there are several powerful trends that we believe will require our customers to invest more in digital investigative solutions like ours. And most notably, the number of cases that has a digital component continues to increase. And the digital component is often the most meaningful part of investigations to date. As digital becomes more pervasive in crime, the growth in both data volume and data complexity makes it harder for law-enforcement to capture and analyze this information. And those issues are compounded by structural operational inefficiencies arising from siloed, manual, and time-consuming processes as well as greater scrutiny on law enforcement practices. In an environment where overall budgets and headcount grow modestly, we continue to see more spending directed to disruptive technologies like ours that can help our customers address these issues and solve more cases faster and more efficiently.

Second, we are well positioned with our existing customers to continue increasing our wallet share through the three-flagship offering in our Case-to-Closure platform, our branded C2C platform. Now these solutions address the key challenges in the digital investigation lifecycle that involves collecting, reviewing, sharing, and analyzing digital evidence. And with spending on our solutions currently representing just a fraction of our customers’ annual budgets, there is a substantial room for upside as digital becomes the primary starting point for an investigation. I'd like to take a moment to elaborate on that.

And within the digital forensic units, the segment where we have established our leadership through relationship with over 5,300 public sector agencies. We are pretty much at the earliest stage of a major product upgrade cycle involving Inseyets, our next-generation digital forensics software solution. Inseyets deliver a more robust integrated set of capabilities that helps our customers access more devices, extract more data, and reveal more information relevant to their investigations. With most of our customers relying on Cellebrite for their primary digital forensics software solution to collect and review digital evidence for mobile phones and other digital witnesses, we see substantial opportunity to better support our customers in the digital forensics units as they broaden the scope of their labs operation and extend our technology also out into the field to support an expanding range of use cases.

Just as important, our customers are increasingly recognizing that they must transform their workflows to drive efficiency and productivity, facilitate better collaboration and strengthen the chain of custody around digital evidence – dynamics which open the door for Guardian, our SaaS-based case and evidence management solution.

And there is also the investigative units. We are augmenting our continued growth in the digital forensics units by accelerating our business in the investigative units of our customers. Maybe more specifically, the digital evidence captured by Inseyets, opens up cross-sell and upsell opportunities for evidence management and analytic solutions. Our offerings for the investigative unit to ensure timely, secure access to digital evidence, dramatically reduced the time involved in reviewing digital evidence and help surface leads and connections buried within mountains of data, all of which is critical to expediting investigations.

As we move forward, we are committed to further enhancing the integration between our flagships offering and further evolving our pricing and packaging in ways that will support broader and more pervasive use of our solutions with national, regional, and local law-enforcement, as well as with blue-chip enterprises and service providers. To fully realize our growth potential, we're making meaningful, I'll say, thoughtful investments, in our technology and our go-to-market initiatives that we believe will further strengthen our ability to address our customers' biggest pain points.

In terms of our technology investments, we will continue to focus on three key areas. The first area is advanced evidence acquisition, which is about making sure we can help law enforcement obtain all the rich information that resides within today's mobile phones, computers, and cloud applications. With Inseyets, customers who've already upgraded, are now extracting substantially more data than they did previously. The second area is about helping our customers leverage the power of the cloud, which will provide, which provides them with greater computing elasticity, facilitate broader interagency and multi-agency collaboration, and minimize IT and security concerns. The third area involves harnessing AI to enable greater automation and increased operational efficiency. We made tangible progress in each of these areas during the first quarter.

From a go-to-market perspective, we are currently broadening our sales coverage in key regions and customer segments in both the US and Europe, while leveraging prior investments to capitalize on opportunities in Asia Pacific. But just to be clear, we are reallocating existing resources as we globalize and optimize certain areas such as sales operations, technical presales, and post-sale customer experience which enabled to add more quota-carrying sales reps and specialists dedicated to nurturing long lead time deals in both digital forensics units and in the investigative units.

A great example for our ability to blend our technology go-to-market and other strategic initiatives to further expand our business over the longer term is in the US federal markets. In mid-March, we announced the launch of the process to authorize our SaaS offerings with the Federal Risk and Authorization management program known as FedRAMP. We do believe that advancing our work over the coming quarters to ensure that our SaaS solution meets the highest standards of security and data compliance will play an important role in our broader efforts to unlock more opportunities in the federal marketplace.

As we advance these initiatives to capitalize to our upgrade, upsell and cross-sell opportunities within our installed public-sector customer base, we will see our technology deployed more pervasively as we extend our reach into new units, new departments, and new buying centers, what we consider to be new sub logos within the logos we've already captured. We also expect that our organic growth will benefit modestly from annual price increases and from the expansion of our private sector business. And finally, our organic growth will benefit as we continue to win net new customers.

Now while new logos typically spend minimally with us in the first year. Their spending growth typically keeps pace with growth of the broader business. And also, thanks to our strong financial foundation, we have the ability to advance opportunities that can accelerate our time to market with high value technology and capabilities as well as extend our reach into growth oriented adjacent markets and capture more of our TAM.

As we move into 2024, our top four strategic priorities remain unchanged. First, increasing our leadership in the digital forensic units. Second, accelerating our growth within investigative units. Third, building our business in the private sector where our differentiated value proposition for data collection by enterprises and service providers is built on supporting a wide range of data sources, different work environments, and deployment flexibility. And fourth, harnessing the power of the cloud.

Now I'd like to briefly highlight the Q1 wins, which help illustrate our progress in executing on each of these priorities. First, our Q1 ARR growth of 27% reflects positively on our ability to extend our leadership in the digital forensic units of our customers. As we look ahead over the next three years, an important strategic objective and fundamental growth driver will be to upgrade the vast majority of our installed base of approximately 32,000 public and private digital forensics software licenses to Inseyets.

And during the first quarter of 2024, which is, by the way, the first full quarter that Inseyets has been available to all customers, we made good initial progress in converting our installed license base to Inseyets. The upgrade to Inseyets delivers substantially higher value in terms of enhanced capabilities and optimized workflows while creating upsell opportunities for customers of all sizes through high value add-on modules that address the needs for lawful access, workflow automation, extraction of other digital sources, and enhanced evidence management functionality. Now we expect to see upgrade activity accelerate during the second half of this year and into 2025 as customers incorporate these investments into their annual budgets.

One notable Q1 Inseyets upgrade involved a larger national police force in South America. We choose that upgrade as an opportunity to broaden its lawful access capabilities to all of its major offices as well as broaden its use of Pathfinder. As a result, we nearly tripled this customer's ARR. In Europe, we were pleased to see a large military agency upgrade to Inseyets to enhance its counterterrorism capabilities for faster trials outside of the traditional lab environment, along with using our Smart Search, our open-source intelligence tool, to generate rapid intelligence on persons and organizations of interest. As a result, this account's ARR more than doubled itself.

Our second priority is to accelerate our growth within the investigative units of our law enforcement customers. Now the key offering for investigators is Pathfinder, our AI powered analytic solution that enables law enforcement agencies to expedite their investigations. Pathfinder substantially reduces the amount of time it can take a detective to view or review text messages, photos, and videos by up to 80% while uncovering and linking data, surfacing new leads, identifying connections and anomalies to capture the most meaningful evidence. And we are pleased with the trajectory for Pathfinder and believe that the investments to add sales specialists will help us accelerate our progress.

Our Q1 Pathfinder wins were highlighted by a midsized city police department in the US Southeast region that plans to use our analytics to support their organized crime unit's ability to conduct cross-case analysis and accelerate investigation involving multiple phones. Now this win extended the scope of our relationship with this customer, increasing our ARR by 30%.

Our third priority is to expand our business in the private sector, primarily in support of corporate investigations and e-discovery use cases. We recently appointed a new Head of Enterprise Solutions to lead the strategic direction and drive product development as we support our customers through both SaaS and on-prem solutions, to collect data from a wide range of devices, regardless of whether the user is working from home or in the office. During the first quarter, we extended our relationship with a Fortune 250 company in the waste management industry. This customer consolidated its data collection activities with Cellebrite by replacing its incumbent solution for support remote computer collection with our Endpoint Inspector SaaS. The win more than tripled our ARR at this account.

And the fourth strategic priority is to help our customers harness the power of the cloud to make it easier, faster, and more secure to accelerate the time to actionable evidence. Now, although law enforcement agencies are generally early into the adoption of cloud technologies, approximately two thirds of our customers expect to adopt cloud-based solutions over the next three years. And we are focusing our development roadmaps and infrastructure investments accordingly. And we are pleased with the interest that is building in Guardian, our SaaS-based solution for case and evidence management.

And during Q1, a large city police department in the US with over 1,000 small offices, selected Guardian to optimize their evidence management workflows. And more specifically, Guardian will help investigators solve more cases by freeing up hours that detectives previously spent on any given case, driving to and from the primary digital forensic labs to drop of devices and pickup evidence reports as well as eliminate the need for detective to purchase their own flash drives and other external storage devices to view digital evidence, reports, and information.

Let's move to slide 7. Now, we head into the second quarter of 2024 with good momentum, especially with respect to our near-term sales pipeline. We continue to see customer budgets trend favorably in support of their plans to enhance and expand their digital investigative capabilities with our solutions over the coming quarters.

To capitalize, we have continued to add talented professionals to our team, which included the appointment of David Gee, as our new Chief Marketing Officer. And looking ahead, we believe we are on track to achieve our 2024 financial targets and have reaffirmed our outlook for this year. And with that said, we know that there is a lot of hard work that lies ahead in order for us to achieve our objectives this year.

So in summary, Cellebrite is well positioned with a differentiated and compelling software platform that is making a tangible difference in accelerating justice through more accessible, intelligent, actionable, and defensible digital evidence. And we are pleased to have continued to onboard talented individuals who share our commitment to advancing Cellebrite's mission.

We expect that our strong financial foundation will be further fortified by our anticipated fundamental performance over the coming quarters. And as a result, we have sufficient fiscal flexibility to consider a wide range of strategic moves that can help us accelerate time to market with high-value capabilities, extend our reach into growth-oriented adjacencies, and enhance shareholder value. And overall, we move forward with confidence that we have the people, the partners, the products, and the programs that will help us capitalize on the exciting opportunities we see. So that concludes my prepared remarks. And at this point, I'll turn the call over to Dana.

Dana Gerner ***Cellebrite DI Ltd - Chief Financial Officer***

Thank you, Yossi. As noted in Yossi's comments earlier, our Q1 results demonstrate that we are off to a very solid start for the year. We delivered revenue above our target, ARR at the higher end of our plan, and stronger than anticipated adjusted EBITDA.

So let's begin the review of the Q1, on slide 9. We reported first quarter revenue of $89.6 million, an increase of 26%. A 29% increase in subscription revenue was partially offset by a more moderate increase of hardware sales within our other nonrecurring revenue and a slight decline of our professional services revenue. Within professional services, the decline in advanced services revenue is correlated with the growth in higher sales of our advanced flow from access offering. And this decline was mostly offset by the growth in training and certification. Overall, subscription revenue represented 88% of total revenue. And we expect that it will continue to trend within the mid to high 80% range over the coming quarters.

Slide 10 details our ARR growth drivers. Our ARR grew 27% year-on-year to $332 million at the end of March 2024. We maintained healthy gross retention of approximately 91% for the first quarter. Our ARR growth was driven primarily by existing customers expansion, with new logos contributing modestly, which is consistent with our growth strategy. In terms of ARR growth by product area, we have continued to see customers expand their use of our Inseyets Collect and Review solutions. This growth is complemented by our continued progress cross-selling and upselling, our evidence management and AI-powered investigative analysis. Our geographic mix for ARR for the 12 months ended on March 31, '24 was generally in line with historical trends, with the Americas representing our largest geography at 52% of total, followed by EMEA at 36%, and Asia Pacific at 12%. We are generally pleased with ARR expansion during Q1 in each major region. With the Americas growing 28%, EMEA increasing 25%, and Asia Pacific up 30%.

Slide 11 details the historical trends for our non-GAAP gross margin and non-GAAP operating expenses, which exclude share-based compensation, amortization of intangible assets, and acquisition related expenses. We reported a first quarter gross margin of 85.7%, which was slightly above our plans and up 260 basis points from the same quarter one year ago. The improvement is due to further efficiencies introduced within our professional services activities combined with an improved margin profile on hardware related sales.

In terms of operating expenses, our first quarter operating costs were $60.9 million, a 14% increase from the prior year. While we have remained disciplined with overall spending, the year-over-year increase primarily reflects the timing and phasing of hiring activity and related costs as well as the timing and magnitude of certain sales and marketing programs, enhancement of our compliance infrastructure, and the impact of other onetime projects. We ended the quarter with 1,052 employees, which was generally consistent with our plan. Looking closer at our hiring during the first quarter, more than half of the new talent we added was within our sales and marketing organization. Geographically, most of our first quarter 2024 new hires were added to support the growth of our business in the Americas and EMEA.

Turning to slide 12. The combination of higher revenue and disciplined spending produced another quarter of improved profitability. We reported Q1 adjusted EBITDA of $70.6 million or 20% on a margin basis versus 10% one year ago. Our Q1 non-GAAP operating income was $15.9 million, with non-GAAP net income of $16.9 million, or $0.08 on a fully diluted basis. We ended Q1 with $347.3 million in cash, cash equivalents, and investments up $15.5 million from the end of the fourth quarter. The increase for the quarter primarily reflected the strong fundamental performance of the business. Our first quarter 2024 free cash flow, defined as cash flow provided by operations less capital expenditure and the purchase of intangible assets was $7.9 million.

Now let's move to slide 13, which details our financial expectations for the second quarter of 2024 and for the full year. Although it is still early in the year, we believe we are well positioned to achieve our full-year targets and have reaffirmed them.

In terms of the second quarter expectation, I'd like to offer some additional color and context. Our expected Q2 ARR in the ranges of $342 million to $350 million represents growth of 25% to 28% and reflects the volume of business closed thus far into the quarter, plus a range of deals in our near-term pipeline. We expect Q2 revenue in the range of $90 million to $94 million, that translates into growth of 17% to 23%. We expect our Q2 gross margins to be at the mid-point to higher end of our full year 2024 gross margin target range of 82% to 84%. We anticipate our Q2 operating costs will increase by low to mid-single digits on a percentage basis over Q1 levels as we continue to fully absorb our first quarter hires and further expand our team during the second quarter. These expectations set the stage for Q2 adjusted EBITDA in the range of $16 million to $19 million. With approximately 52% of our revenue expected in the second half of the year, we still expect that the majority of adjusted EBITDA will be produced during these periods as we manage our cost base, with relatively marginal anticipated quarter-over-quarter expansion. This implies that we expect approximately 52% to 58% of our anticipated full year 2024 adjusted EBITDA to be generated in the second half of the year.

In summary, Cellebrite delivered a solid first quarter performance. It has been gratifying to see our value proposition resonating in the marketplace. As we move forward well positioned to support our customers as they increase their spending on our solutions. By delivering the Cellebrite brand promise of justice accelerated and executing against our strategic priorities, we expect to remain on course to achieve our financial objectives this year. That concludes our prepared remarks. And I'll turn the call back to the operator for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Shaul Eyal, TD Cowen.

Shaul Eyal ***TD Cowen - Analyst***

Thank you. Good afternoon, good morning. Congrats on 1Q results. Yossi, the business seems to be kicking on all cylinders. I wanted to start by asking on the potential business upside you could be seeing from FedRAMP, that you guys have announced earlier in March.

Yossi Carmil ***Cellebrite DI Ltd - Chief Executive Officer, Director***

Shaul, first of all, thank you for that. Indeed, in mid-March 2024, we announced the launch of the process to authorize our SaaS offering with FedRAMP. Now, FedRAMP is an important initiative, I would say, for us. And in the context of potentially doubling our total addressable market, specifically in the federal market space in the United States and over the longer term clearly and opening, I would say, substantial opportunity over the coming years. Clearly benefit of accessing additional buying centers within the already existing logo and secure higher budgets in 2025.

The FedRAMP represents an area of significant investment during 2024. This is something which is important to emphasize, which, by the way, had been factored into our 2024 outlook. And the FedRAMP will initially apply to our Guardian platform and the infrastructure that supports the Guardian. But once the work is done, it will make it easier to deliver other cloud-enabled offering of our FedRAMP certified platforms. And maybe one thing that needs to be emphasized, important element of FedRAMP is an important element of a broader plan to expand the business with the federal customers. And maybe in that context, just emphasizing that it will contribute clearly to value proposition, our C2C platform in the context of an end to end. And clearly long growth runway for a substantial ARR growth in the future.

Shaul Eyal ***TD Cowen - Analyst***

Understood. Maybe kind of you front-run me on as maybe double-clicking on the C2C, the Case-to-Closure platform that you've just mentioned. Maybe talk about the early adoption you might be seeing among the other public sector customers? Anything you can add along these lines?

Yossi Carmil ***Cellebrite DI Ltd - Chief Executive Officer, Director***

Yeah, absolutely. Look, the C2C, the Case-to-Closure is clearly in a very early stage. We have -- and this is very encouraging news basically for any Cellebrite investor. Because we have 5,300 public sector customers. The percentage of customers who have deployed, I would say, the combination of Inseyets, Guardian, and Pathfinder as a total package is currently very small.

Now I would say that we are very optimistic of our installed base of public sector customers and their ability to deploy multiple Cellebrite solutions within the C2C platform, especially as we more tightly integrate and I spoke about it on the Investors' Day, actually investing a lot in streamlining these solutions, not to mention the cloud enablement side-by-side with on-prem.

Now we do believe that the cloud enablement -- by the way is part of this, cloud enablement of our solution will make it even easier for customers to adopt more solutions within the C2C platform. And we expect further progress on our product road map in that direction. I hope that covers your question.

Shaul Eyal ***TD Cowen - Analyst***

No, absolutely. Loud and clear. Thank you for that. I'll cede the floor. I may come back later for additional questions. Congrats.

Yossi Carmil ***Cellebrite DI Ltd - Chief Executive Officer, Director***

Thank you.

Dana Gerner ***Cellebrite DI Ltd - Chief Financial Officer***

Thank you.

Operator

Brad Zelnick, Deutsche Bank.

Bhavin Shah ***Deutsche Bank - Analyst***

Great. Thanks for taking our questions. This is Bhavin on for Brad, and congrats on the solid start to the year. Can you just elaborate a little bit more on Inseyets? And it's great to hear some of the early success that you're seeing there. But just can you give us some more elaboration in terms of what drives your confidence that the majority of customers will upgrade over the next three years from, you said, to Inseyets. And secondarily, how do we think about the monetization opportunity and the uplift that you might see as customers migrate?

Yossi Carmil ***Cellebrite DI Ltd - Chief Executive Officer, Director***

Okay maybe I'll take it for a start -- sure, I'll take it. Look, our goal is to upgrade the vast majority of our installed base to Inseyets over the next three years. And 2024 goal, I would say, to upgrade more than 10% of our installed base to Inseyets. I must say that I mentioned that by the way, during my speech earlier, that we launched it actually for the first time in this quarter in full. And I have to say, and I'm glad to say, that the interest in Inseyets is high with very favorable feedback from early adopters.

And this is by the way, while we haven't announced any plans to sunset the legacy digital forensic solutions, maybe UFED or the Premium. But it is obviously reasonable to expect that on a timely manner, where we will sunset, it will basically accelerate the process. The Inseyets maybe to deliver considerable more value than the legacy offering. And the higher value obviously enable us, I would say, command and enable us higher price tag that is approximately 20% to 25% higher than the comparable legacy solutions. And we expect that the upgrading, the vast majority of the installed base of installs will be completed within the next three years.

Maybe last word, there is also the enterprise, the private sector. And for the private sector, we also see good traction as our next-generation solution to add the complex data collection requirements for the private sector customers and obviously, for the service providers. So I'll stop here. Dana, I don't know if you want to add anything?

Dana Gerner ***Cellebrite DI Ltd - Chief Financial Officer***

No, I think you fully covered the question.

Yossi Carmil ***Cellebrite DI Ltd - Chief Executive Officer, Director***

Is it?

Bhavin Shah ***Deutsche Bank - Analyst***

Thank you though, that was extremely helpful. And just one follow-up for me. Just on kind of some of the go-to-market changes that you're making and kind of broadening the coverage in the US and EMEA. How should we think about the payback period on some of these investments, given there's -- there are long sales cycles here. And then could there be any disruption as we think about just as you optimize sales operation, customer experience, et cetera?

Dana Gerner ***Cellebrite DI Ltd - Chief Financial Officer***

Maybe I'll start. Actually, we have a very solid model on return on investment of, say, introducing a new quota carrier. So we have a clear internal KPI that we take into consideration when we decide on increasing our quota carrier teams. I would say that a reasonable onboarding period for a quota carrier until we see a high level of return investment is around six months, since the sales maybe shorter. So even with the longer sales cycles, we are seeing return investments in a manner of two to three quarters with our quota carriers. We did mention that we are reallocating OpEx to support the increased quota carriers, Americas, EMEA mainly, but also in APAC. But it is also from other activities that we are doing, and we can actually do it by introducing efficiencies into our systems, processes, compliance, integration, and so forth. So we do not see or expect any, I would say, shortfall on our ability to support the increased business.

Operator

Jonathan Ho, William Blair.

Jonathan Ho ***William Blair - Analyst***

Hi, good morning and congrats on the strong quarter. I just wanted to understand, just given your strong performance to start the year, why not raise the guidance for the full year? Just trying to understand if there's any deals that came in earlier than anticipated or if there was any movement between the quarters?

Dana Gerner ***Cellebrite DI Ltd - Chief Financial Officer***

So, first of all, we started the year by saying that we will start providing quarterly guidance. And this was to enhance our transparency and the ability for the investors and the analysts to have better insight on our plans and our performance. And I'm glad to say that we've done it last quarter. I mean, we're doing it this quarter in a very constant manner. We are off to a solid start, but we have considerably more work to do ahead of us, as Yossi mentioned in his prepared comments. And we believe it's a little bit premature to start changing our outlook at this stage of the year, although we are fairly confident with our guidance and our ability to execute.

Operator

Mike Cikos, Needham.

Mike Cikos ***Needham & Company LLC - Analyst***

Hey, thanks for taking the questions guys, and I apologize for any background noise. I wanted to come back to Yossi's prepared remarks. And I think one of my colleagues had asked about Inseyets and its conversion process or upgrade cycle that we're on the cusp of. Can you further elaborate on how Q1 played out with respect to how those conversion rates trended versus your internal plan? As well as I know it's probably early here, but are you guys actually seeing that ASP uplift? I know we're talking about 20% to 25% is what we're expecting but is that starting to bear out now that we have a full quarter under our belt here?

Yossi Carmil ***Cellebrite DI Ltd - Chief Executive Officer, Director***

Well, I would say the following. As I said, I look at it long-term and I'll get to 2024 in a second. As I said, we want to -- in a perspective of three years, to upgrade the vast majority of the installed base. And clearly, there are some factors that can influence that. For example, one of them, the exact percentage of anticipated conversion can depend on the timing of already existing multiyear subscription and obviously certain levels of churn.

In Q1 2024, I think you were asking about that, there was good initial progress. We are very satisfied to where we stand. I would say that

-- and I think I mentioned that we are expecting an upgrade of more than 10%, so 10%-plus basis target, I would say, based on budget cycles. Many customers will build this into their 2025 and into their 2026 budget. And clearly, obviously, that has been factored to avoid any misunderstanding in our financial expectations. And we expect to see an upgrade activity build, I would say, during H2 of this year and basically to build the momentum for 2025.

Dana Gerner ***Cellebrite DI Ltd - Chief Financial Officer***

I would say that from the RPC, we are seeing high-teens increase in price, which is a great success considering the fact that those early adopters did not included this increase in their budget. So their ability to introduce it in the first year and not wait for it for the second and third year, we find it very, very much encouraging.

Operator

Eric Martinuzzi, Lake Street.

Eric Martinuzzi ***Lake Street Capital Markets, LLC - Analyst***

Yeah. You talked about gross margin range of 82% to 84%, yet you had the 85.7% non-GAAP gross margin in Q1. Was there anything to call out in Q1 that goes away, so to speak, in forward quarters?

Dana Gerner ***Cellebrite DI Ltd - Chief Financial Officer***

Yeah, I think if you look at our gross margins related to subscription, that we provide in the additional financial deck, it's around 7.5% of cost to subscription. With the further introduction of a cloud-based and SaaS offering, we expect our costs around subscription to increase over time, especially around hosting and cloud operation. And further, the more we will of the installed base of Inseyets will be transitioned to -- from UFED to Inseyets, we will see a little bit more of also hardware sales to come with very marginal gross profit. As such, this is why on the full-year basis, we are talking about 82% to 84%.

Operator

Brian Essex, JPMorgan.

Brian Essex ***JPMorgan - Analyst***

Hey, good morning and thank you for taking the question. Maybe just a follow-up on Shaul's FedRAMP question. Would like to know how that's progressing so far? How long you think it will take? And do you think you'd be able to complete the process fast enough to benefit from the 3Q federal spending cycle this year? Or is that a longer-term issue more to benefit growth in the following years?

Yossi Carmil ***Cellebrite DI Ltd - Chief Executive Officer, Director***

I would say that we expect, I would say, to finish the process of that initiative in the first half of 2025 with audit to be ready by end of 2024. That means that we will be able the way we -- and I have to say, that we are standing very well right now. We published about the process that we do with Coalfire in order to build the site and the testing and the applicative part. And I can also say that we have a sponsor and even more than one as part of the process. Meaning, that if all goes well, audit end of 2024, it means that we can embed that into discussions with customers about business in 2025 and finishing the process in the first half of 2025.

Brian Essex ***JPMorgan - Analyst***

Great. Super helpful. And maybe just a follow-up. Yossi, in your prepared remarks, you've talked about expanding exposure to the private sector and particularly, you called out, I believe a Fortune 200 waste management provider, replacing incumbent solutions there. Maybe a little -- could you offer a little color in terms of what you replaced and how applicable this will be to other customers within the private sector?

Yossi Carmil ***Cellebrite DI Ltd - Chief Executive Officer, Director***

Absolutely. First of all, maybe as a generic statement, private sector revenue and ARR performed, I would say, reasonably well in the beginning of the year. By the way, same as it was last year and over the past six months. And I mentioned one leadership position, we actually on an upgraded two positions, Q4 '23, a new sales leader as part of the CRO organization and the new Head of Enterprise Solutions in actually the beginning of Q2 2024. So I have to say that we are optimistic that we will achieve our targets for the private sector revenue and ARR for 2024.

And maybe on top of that, the focus here and you were asking about the Fortune 250, that customer that I mentioned is part of the Fortune 250. We are clearly targeting to blue chip enterprises and large and mid-sized service providers. We are targeting to mainly to litigious industries where the element of e-discovery and internal corporate investigations is critical and meaningful. So that that's part of that effort. Again, major focus is to be what we are world champion in advanced and remote advanced collection. On top of that, I'm glad to say that recently, we also executed a strategic review of that entire segment with some clear vectors of progress into the near and midterm future that makes us also more confident. So I hope I gave enough view on that.

Operator

Jeff Van Rhee, Craig Hallum.

Jeff Van Rhee ***Craig Hallum - Analyst***

Great thanks for taking my questions. Yossi, just along the levels of kind of the high-level outlook in the second half embedded in the guide, how has your macro thinking evolved in the last 90 to 180 days?

Yossi Carmil ***Cellebrite DI Ltd - Chief Executive Officer, Director***

Generally about the, I would say, the macro environment, so the market?

Jeff Van Rhee ***Craig Hallum - Analyst***

Yes.

Yossi Carmil ***Cellebrite DI Ltd - Chief Executive Officer, Director***

Look, I'm glad to say that -- I'll split it. Obviously, the major focus is related to the public sector. And over there, I would say that everything that we had anticipated in terms of factors and drivers remain the same. The market is healthy. The drivers that we spoke, which are pushing our technology in the context of disruptive technology is there and the spending of our customers are anticipated to stay the way they are with even additional possibility of upside.

That statement is valid, I would say, both for the state and local government and for the federal. In that context, by the way, maybe worth emphasizing that and talking about spending, we need to remember that in that relatively healthy environment, the spending on Cellebrite at the moment is really fraction of what those customer spend. So we are pretty much, I would say, a secure ground to believe that what we are anticipating to develop or to execute will be according to what we plan. I hope that helps.

Jeff Van Rhee ***Craig Hallum - Analyst***

It does. Understood. And if I could, one other question on the new logo front, understanding the opportunity to just go into the base and upsell. But looking at the new logos, are there any lessons to be learned there in terms of the effectiveness of the C2C platform or Inseyets, in terms of higher win rates, broader adoption at initial purchase, any observations there?

Yossi Carmil ***Cellebrite DI Ltd - Chief Executive Officer, Director***

As I said to the -- I would like basically to split my answer. The element we have in the public sector, 5,300 agencies. Within those 5,300 agencies, there is a large amount of large, what we call strategic, and mid high prime accounts. And over there, our -- and I mentioned that in my opening, there are many sub-logos/new buying centers, untapped buying centers, untapped professional centers within that logo.

So if I go back right now to the C2C. One, good news early stage. Second, the ability, basically while streamlining it and while bringing more value between the three flagships, the Inseyets collect and review the access on the front end, the Pathfinder AI-based analytics on the backend, and the bridge with evidence management and case management and the streamline between them, and will enable us more and more to penetrate in more sub logos/profit centers/buying centers.

The good news, we are in an early stage, but I'm glad to see, I would say, that if I look at our pipe, the amount or the cases especially by the large and midsized customers that we see more than one or two solutions based on that combination is increasing dramatically, especially by the way on the state and local government side.

Jeff Van Rhee ***Craig Hallum - Analyst***

Got it. Very helpful. Thank you.

Operator

Louie DiPalma, William Blair.

Louie DiPalma ***William Blair - Analyst***

Yossi, Dana, and Andy, good morning.

Dana Gerner ***Cellebrite DI Ltd - Chief Financial Officer***

Good morning.

Louie DiPalma ***William Blair - Analyst***

It seems price is expected to be a significant driver of growth over the next three to five years? And are there three primary upgrades taking place for the installed base of 32,000 licenses? First, is there the Inseyets upgrade and then the C2C upgrade for the end-to-end ecosystem? And then third, the on-premise upgrade to the cloud? And do all three of these upgrades involve higher pricing for the increased value that you're providing?

Dana Gerner ***Cellebrite DI Ltd - Chief Financial Officer***

I think that if we look at the long-term model, Louie, the main driver of our expansion in the coming years will be really linked to the increased digital data that our customer needs to process. So either you can call it a price increase because the Inseyets now can do double the work and much more efficiency -- with much more efficiency -- so actually, we are setting more capacity with the same number of licenses in a reasonably higher price. Or you can actually look at the expansion that we are looking to do within the investigative units with Pathfinder and the Guardian that I think we discussed in the past, we believe that this market can grow 35% to 50% year over year. So these are the main two drivers. The ongoing price increase of the same offering year-over-year, I would say, baked into our model is around 4%. So this is not the main issue. And Inseyets is not a price increase. It's a different offering with a different value and a different tag price in our point of view. I hope this was helpful.

Louie DiPalma ***William Blair - Analyst***

Great. Yes. And you reached a 20% EBITDA margin in the first quarter, which is typically, Dana, your lowest margin quarter. Is this 20% margin sustainable going forward even with the increased headcount and investments? And should margins be like, smoother on a quarter-to-quarter basis going forward than they have been in the past?

Dana Gerner ***Cellebrite DI Ltd - Chief Financial Officer***

We believe that throughout the years, you will see smoother margins quarter-to-quarter because with the transition to subscription, we'll see also smoother revenue increase, which will be aligned with the marginal increase in OpEx quarter over quarter. Our model speaks about 20%-plus EBITDA in the midterm. We are very, very satisfied with Q1, but Q1 was not fully representing our OpEx plans for the full year in a nutshell.

Louie DiPalma ***William Blair - Analyst***

That makes sense. Thanks, everyone.

Operator

(Operator Instructions) Tomer Zilberman, Bank of America.

Tomer Zilberman ***BofA Global Research - Analyst***

Hey, guys. Maybe just one quick one to touch up on an earlier question. Can you just talk about how much visibility you have into demand for the remainder of the year? Less on expectations to the guidance, but how much visibility can you see?

Dana Gerner ***Cellebrite DI Ltd - Chief Financial Officer***

So when we look in the opportunity management process that we have in the company, we have a great visibility into the coming two quarters, so Q2 and Q3. And I would say, which make us very confident in our ability to deliver the full year definitely in a nutshell.

Tomer Zilberman ***BofA Global Research - Analyst***

Got it. Thank you.

Operator

Mike Cikos, Needham.

Mike Cikos ***Needham & Company LLC - Analyst***

Hey, thanks for getting me back on here, guys. I did just want to follow up, I know that how you expect an acceleration in upgrade activity in the back half of this year into calendar '25, which makes sense intuitively as customers are building in additional budget. But I just wanted to get a better sense. When we think about the guidance that you have constructed today, is that acceleration embedded in the guide or is that seen as more of a potential upside catalyst?

Dana Gerner ***Cellebrite DI Ltd - Chief Financial Officer***

The 10%-plus is embedded in our plans for the year. The budget for next year, while will see the opportunity start to build this year, most of them will be realized in '25.

Mike Cikos ***Needham & Company LLC - Analyst***

Okay. And with the -- I know Marcus, your new Chief Revenue Officer did a great job at the Investor Day in March. But just imagine that he's been charged with helping in some way accelerate (technical difficulty) ability to build that budget, right, to help your conversions. Is that where we should think about driving towards when you look at the hires and the go-to-market effort around whether it's presales or instituting some of these different sales operations that you guys have? Is that a fair characterization? Or is there anything else that we're missing there?

Yossi Carmil ***Cellebrite DI Ltd - Chief Executive Officer, Director***

Mike, I'm not sure that I understand the question, but at least I'll try. First of all, I would agree completely with the statement that Marcus has done and is doing and will do a great job. But putting that aside, the focus is on -- functionality wise, the focus is on a strong mix between quota carriers and post-sale customer success, which are the two major direction and vectors where we're going to invest the money. And internally, there is a potential for acceleration.

Mike Cikos ***Needham & Company LLC - Analyst***

I guess, thanks for that. Sorry to be mixed up on the question here. I guess, is there a way for Cellebrite to help customers accelerate their internal process, to help get that budget sooner for this upgrade? Right, are you able to do anything on that front to help them get additional funding for Cellebrite? I'm hoping that question makes sense.

Yossi Carmil ***Cellebrite DI Ltd - Chief Executive Officer, Director***

Okay. It makes sense. And there are possibilities in that direction. There are cases that there are special grants, which are being created by customers. End of last year, by the way, we hired for the first-time people in the area of grant management, which are doing exactly that. And that enables us to support them to create those extra grants and create additional budget opportunities.

Operator

This concludes the question-and-answer portion of today's call. I would now like to turn the floor over to Cellebrite CEO, Yossi Carmil, for additional or closing remarks.

Yossi Carmil ***Cellebrite DI Ltd - Chief Executive Officer, Director***

I would like to thank you again all for participating. Thank you also for the interest and the trust in Cellebrite. And above all, I would like to thank my colleagues, the Cellebrite employees for performing for us for Q1 and well done and good luck to us for the rest of the year. Thank you.

Operator

Thank you. This concludes today's Cellebrite first-quarter 2024 financial results conference call. Please disconnect your line at this time and have a wonderful day.