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Freshworks, Inc. (FRSH)

Q4 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Hello and welcome to Freshworks' Fourth Quarter and Full Year 2024 Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. Please be advised that today's conference is being recorded. I would now like to hand the conference over to your first speaker, Joon Huh, Head of Investor Relations. Please go ahead.

Joon Huh

Senior Vice President-Finance, Investor Relations & Treasury, Freshworks, Inc.

Thank you. Good afternoon, and welcome to Freshworks' fourth quarter and full year 2024 earnings conference call. Joining me today are Dennis Woodside, Freshworks' Chief Executive Officer and President; and Tyler Sloat, Freshworks' Chief Operating Officer and Chief Financial Officer.

The primary purpose of today's call is to provide you with information regarding our fourth quarter and full year 2024 performance and our financial outlook for our first quarter and full year 2025.

Some of our discussions and responses to your questions may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on Freshworks' current expectations and estimates about its business and industry, including our financial outlook, macroeconomic uncertainties, management's beliefs, and the timing of future repurchases of our Class A common stock, and certain other assumptions made by the company, all of which are subject to change.

These statements are subject to risks, uncertainties and assumptions that could cause actual results to differ materially from those projected in the forward-looking statements. Such risks include, but are not limited to, our ability to sustain our growth, to innovate, to reach our long-term revenue goals, to meet customer demand, and to control costs and improve operating efficiency.

For a discussion of additional material risks and other important factors that could affect our results, please refer to today's earnings release, our most recently filed form 10-K, and other periodic filings with the SEC. Freshworks assumes no obligation to update any forward-looking statements in order to reflect events or circumstances that may arise after the date of this call, except as required by law.

During the course of today's call, we will refer to certain non-GAAP financial measures. Reconciliations between GAAP and non-GAAP financial measures for historical periods are included in our earnings release, which is available on our Investor Relations website at ir.freshworks.com.

I encourage you to visit our Investor Relations site to access our earnings release, supplemental earnings slides, periodic SEC reports, a replay of today's call or to learn more about Freshworks. And with that, let me turn it over to Dennis.

Dennis M. Woodside

Director, President & Chief Executive Officer, Freshworks, Inc.

Thanks, Joon, and thank you, everyone, for joining us today on the call. Q4 was another great quarter across the board for Freshworks. We outperformed all our key metrics and exceeded our previously provided estimates for growth and profitability, finishing the year on a high note.

We ended the year with over 72,200 customers who've chosen Freshworks' CX and EX software to transform their business. Time and again, overpriced legacy software vendors with overcomplicated products drive customers directly into our hands. Customers choose Freshworks uncomplicated software to deliver powerful productivity gains for IT, customer support, and other business teams.

In Q4, revenue grew 22% year-over-year to \$194.6 million, beating our previously provided estimates. We delivered a non-GAAP operating margin of 21% and generated adjusted free cash flow of \$41.7 million, resulting in an adjusted free cash flow margin of 21% for the quarter, also outperforming expectations. We added over 2,600 net customers in Q4, representing the largest quarterly increase in four years.

We welcomed and onboarded notable customers, including Mesa Airlines, retailers like New Balance and Rawlings Sporting Goods and software companies like Sophos. We saw healthy expansion activity and maintained a similar net dollar retention of 105% on a constant currency basis compared to the prior quarter.

We also succeeded in expanding our business with many existing large customers, including Amex GBT, Coherent, Klarna, EDF Renewables and UCLA. Our strategy to drive durable and profitable growth is working. Our first imperative is investing in EX. We are doubling down on our largest, fastest-growing employee experience business, which includes ITSM, ITAM, ITOM and ESM.

Our second imperative is delivering AI capabilities across our products and platform. We are driving productivity improvements for our customers in both employee experience and customer experience. Our third imperative is accelerating growth for our customer experience solutions, including our customer service and sales and marketing products.

Now, I'll share exactly how our execution against our strategy led to the strong Q4 results. First, our investments in EX are paying off as we continue to drive up-market momentum. Q4 was another strong quarter for our EX business.

We surpassed \$400 million in ARR and grew 35% year-over-year on a constant currency basis. Our underlying business fundamentals continue to be strong. We did see meaningful FX impact on our reported numbers, which Tyler will cover in greater detail later in the call.

We ended the quarter with 18,300 customers in EX. Several trends within our business are driving growth. Continued up-market success, expansion with ESM, attaching Device42 to new and existing accounts, and building a leadership position in specific industries.

First, more and more mid-market and enterprise customers are turning to Freshworks as they leave behind our largest IT competitors. We believe that's because big SaaS vendors are overcharging and underserving their customers, particularly in the mid-market. We offer the alternative, software that's enterprise-grade without unnecessary complexity.

Over 75% of the ARR in our EX business comes from mid-market and enterprise companies, which we define as organizations with 250 or more employees. Iconic companies, major city governments and manufacturers are turning their backs on legacy SaaS vendors and coming to Freshworks.

Recently, a multi-billion dollar hard drive manufacturer dropped ServiceNow after a 13-year relationship to embrace Freshservice. The city and county of San Francisco and Mesa Airlines also chose us over ServiceNow

in Q4. Universities and healthcare providers are choosing Freshservice over others, too. Denver Health, a leading provider of hospitals, emergency care and community health centers needed to modernize its IT operations.

By replacing its legacy ITSM tool with Freshservice, Denver Health can protect the security and privacy of patient data while automating important tasks so that employees can provide patient care.

The second big trend driving our EX business is our ongoing success in ESM with Freshservice for business teams. ESM is a key lever for expansion, and in new deals, the attach rate increased to 25% in Q4.

Monetization momentum continued to build with ESM ARR growing 2.5x in 2024, and one out of five eligible customers utilizing Freshservice for business teams. Alterra Mountain Company, TeamViewer, Wake Forest University and Coherent are all using Freshservice in other areas of their businesses, including HR, marketing and finance to deliver amazing service experiences.

Alterra Mountain company, owner of the popular Ikon Ski Pass, operates 18 year-round resorts. They wanted a single technology solution to enable smoother collaboration between departments and locations. After seeing success with Freshservice in their IT environment, Alterra expanded its use of Freshservice across more departments, including HR, facilities, finance, sales and marketing.

Coherent, a global manufacturer of industrial and laser equipment, transitioned 500 internal agents and all ITSM workflows from multiple tools, including ServiceNow to Freshservice. Coherent recently expanded its use of Freshservice beyond IT to their HR department, supporting 25,000 employees. They have plans to expand Freshservice to additional teams, such as facilities and procurement. In Q4, we made product improvements to further strengthen our offering for teams outside of IT.

We launched new connectors for major human capital management tools, like UKG and Personio, and have a strong pipeline of integrations with more HR apps, including ADP and Paylocity, going live in the coming months. The third EX growth driver is our advanced ITAM offering with Device42. In Q4, we launched a new integration to create a more seamless experience for customers using Freshservice with Device42.

Companies can enhance their operations with comprehensive infrastructure auto-discovery and dependency mapping, delivering deeper, more actionable insights to power their IT operations. The combined offering is easier to configure than the competition, which contributed to an increase in upsell of advanced ITAM capabilities into existing Freshservice customers. Three of the top 10 deals we closed in Q4 included a Device42 attach element, and Q4 represented the highest net new ARR quarter ever for the Device42 business.

Major sportswear brand New Balance is experiencing rapid growth and posted record sales in 2024. They utilize Freshservice enterprise and Device42 to offer a global online portal for all internal support needs. The integration of Device42 for advanced asset management and its CMDB gives New Balance an accurate view of its IT infrastructure across locations. AI-powered self-service capabilities accessible through the portal, Microsoft Teams and email will empower associates with an intuitive and modern support experience.

We continue to attract education and sports organizations, solidifying our leadership position in these industries. In education, Wake Forest University, UCLA, and Manchester Metropolitan University use Freshservice for digital transformation. In professional sports, almost one-third of the National Football League and Major League Baseball teams use Freshservice. The San Francisco 49ers, Kansas City Chiefs, Indianapolis Colts and Arizona Cardinals are just a few of our NFL customers. In Major League Baseball, the San Francisco Giants, Cleveland Guardians, Minnesota Twins and Houston Astros are customers.

We also have a number of European football clubs such as Paris Saint-Germain, Everton and Southampton as customers, and multiple F1 teams like McLaren Racing. We believe that companies that care about their employee experience choose Freshservice, software that's enterprise-grade without enterprise complexity.

On to our second imperative, AI. We expect AI to be a tailwind for our business as customers are realizing tangible business value. After launching Freddy Copilot in February, we ended the year with more than 2,200 customers, reflecting quarterly net adds of more than 500 or 30% growth quarter-over-quarter. We're seeing monetization payoffs for Copilot in its first year, ending with ARR ahead of our internal targets.

In a world of hype and jargon, we are successfully taking customers from AI experimentation to execution. Take the Kansas City Chiefs, for example. The Chiefs use Freddy AI Copilot with Freshservice to improve productivity across IT and finance departments.

For several years, Freshworks has been helping them find ways to win off the field. In Q4, we maintained over 50% Copilot attach rates for new deals of \$30,000 or more. Attach rates for SMB continued to be double-digits and increased quarter-over-quarter. With the launch of Freddy AI Agent for CX, we combined our Freddy AI self-service features into this new product. By the end of the year, over 1,300 customers were using Freddy AI Agent, including 100 customers testing the latest beta version. As our AI agents improve, more customers are using them and seeing positive results.

Freshworks is committed to turning AI into ROI for businesses of all size. Take AdaptHealth, for example, a home healthcare company that serves 4 million patients. The IT team uses Freddy AI Agent to speed resolution times and deflect tickets. This frees up time for the team to focus on improving patient outcomes. We are excited about the progress we've made and expect to see meaningful progress on AI monetization in 2025, with anticipated widespread adoption of Freddy AI.

Finally, I'll cover CX, our flagship business that's been paving a better way forward for service software for over a decade. This is another area where we see strong momentum, especially in the SMB segment, and was a significant contributor to our net new customer adds this quarter. We ended the quarter for CX with over 58,200 customers, generating over \$360 million in ARR, growing at 7% year-over-year on a constant currency basis, similar to the constant currency growth rate in Q3. With an initiative that we started mid Q3, we're seeing ongoing conversion of free to paid customers, largely in the SMB segment.

This initiative benefited the CX business and significantly contributed to the customer net adds for CX, which was more than 2,000 for the quarter. We are largely through the vast majority of conversions, so expect to see a smaller benefit in Q1. Amazing large organizations are choosing Freshdesk, including Airbus and AMC Networks. Satair, a wholly owned subsidiary of Airbus, adopted Freshdesk to effectively communicate and resolve tickets from customers, suppliers and employees. They have seen a 40% reduction in average ticket handling time and a dramatic reduction in onboarding time from one month previously to two to four days with Freshdesk.

In Q4, we made updates to Freshdesk's support admin features, as well as our supervisor experience, which delivers advanced analytics to our customers. We also launched integrations with Playvox Workforce Management, an important feature for customers like Stitch Fix. It is clear to us that these product improvements contributed to solid retention rates, which remain stable from Q3.

We believe our CX products have several strong expansion paths. First, CX customers are leading the charge in adopting our AI products. Second, we saw growth in our total agent counts across the business as seats

increased quarter-over-quarter. Third, CX customers are also buying EX and vice versa. For example, Dune London, a growing footwear and accessory retailer, wanted a unified solution to support customer inquiries and manage internal IT processes. Dune first had success with Freshdesk and Freddy AI, which deflected 40% of tickets. They recently added Freshservice with Freddy AI Copilot to assist their IT team.

iPostal1 is the largest provider of digital mailbox services, and has been using Freshdesk for years as a scalable solution to manage its expanding customer base of over 1 million. After seeing the value of Freshdesk in their business, they adopted Freddy AI and Freshservice to streamline internal operations. Freddy AI agents are saving their agents time and resolving 54% of their queries. iPostal1 has also expanded their use of Freshservice to legal, product management, operations and HR.

In Q4, we welcomed our new Chief Product Officer, Srini Raghavan, to the Freshworks' executive leadership team. Srini, who brings extensive experience leading AI and automation initiatives at RingCentral, Five9 and Cisco, will shape the next chapter of innovation at Freshworks and will play a key role in shaping our CX and EX products going forward.

Last week, we also welcomed Venki Subramanian, SVP of Product Management to the CX leadership team. Venki has held leadership roles at SAP and ServiceNow, where he launched and scaled their customer experience and CRM products. We continue to attract world class talent in every function, all focused on delivering for our customers uncomplicated solutions.

Looking ahead, we're driving new avenues of growth through strategic partnerships that are unlocking a more diverse pool of customers. Today, we have more than 500 active partners globally, from large value-added resellers, solution providers, system integrators, distributors and sales consultants. Our partners touched one-third of our ARR in 2024 and many more customers through sales and service implementations.

We are excited to announce a new strategic agreement with Unisys, a leading global SI partner. Unisys was looking for a modern IT solution to deliver for their large and mid-market customers, and after completing a competitive review process, they chose Freshservice. Initially, Unisys will partner as a reseller of our products with future plans of leveraging our solutions for an MSP offering. We're excited to work with Unisys, and this partnership highlights our strong momentum with mid-market and enterprise companies.

As we evolve and execute on our partner strategy, we expect to see increased efficiencies in our go-to-market efforts, leading to additional margin improvements in the business. I am incredibly excited about the opportunity ahead and in 2025. We have a competitive advantage with our enterprise grade software that delivers results fast. We have an experienced and talented leadership team. We are focused on efficiently scaling and are well positioned to be a leading enterprise software company.

Thank you to our customers, partners, employees and shareholders for your ongoing support. Now let me turn it over to Tyler to go through the operational and financial details.

Tyler Renwick Sloat

Chief Financial Officer & Chief Operating Officer, Freshworks, Inc.

Thanks, Dennis, and thanks, everyone for joining on the call and via webcast today. For our call today, I'll cover the Q4 and full year 2024 financial results, provide background on the key metrics, and close with our forward-looking commentary and expectations for Q1 and full year 2025. As a reminder, most of our discussion will be focused on non-GAAP financial results, which exclude the impact of stock-based compensation expenses,

restructuring charges, and other adjustments. We will also talk about adjusted free cash flow, which excludes a cash outlay related to the restructuring costs in Q4.

We are pleased to report another outstanding quarter and a strong finish to the year, as we surpassed both our previously provided top line and bottom line estimates in Q4. We made significant improvements to our overall cost structure, expanding our non-GAAP operating margin by 800 basis points quarter-over-quarter to 21%, as well as growing our adjusted free cash flow 46% year-over-year to \$41.7 million, which resulted in a strong adjusted free cash flow margin of 21%. These results reflect the successful execution of our strategic initiatives, as we remain confident in our ability to drive profitable growth for our business.

Let me first start with FX, as this had a meaningful impact on our reported numbers in Q4. We observed the notable shift in FX rates throughout the quarter, driven by the strengthening of the US dollar. Q4 revenue impact was minimal, but this resulted in a 3 percentage point negative impact to our ARR growth, or \$17.5 million reduction to our ARR. As such, I'll include constant currency comparisons for many of the metrics to provide a better view of our underlying business trends.

Starting with the income statement, total revenue in Q4 increased to \$194.6 million, growing 22% on a reported basis and 21% on a constant currency basis. Professional services revenue contributed \$2.4 million in the quarter, as we continue to shift services revenue to our growing partner network. Device42 revenue contribution was approximately \$10.3 million for the quarter. Half of the net new ARR for Device42 originated from the Freshworks' field team, as we realized cross-sell synergies from the acquisition.

Our EX business remains our primary driver of overall growth for the business, which, as Dennis noted, has now surpassed \$400 million in ARR, growing 33% year-over-year on an as reported basis and 35% on a constant currency basis. Excluding Device42, EX growth was 22% year-over-year on an as reported basis and 25% on a constant currency basis. Our CX business is at over \$360 million in ARR and continues to perform well, growing at 6% year-over-year on an as reported basis and 7% year-over-year on a constant currency basis.

Moving to margins, we improved our strong non-GAAP gross margin for Q4 to over 86% as we continue to efficiently deliver our solutions and support our customers. This represents an improvement of approximately 200 basis points compared to the prior year. Our non-GAAP operating income for Q4 came in at \$40.3 million, representing a non-GAAP operating margin of approximately 21% and ahead of prior expectations. The strong performance is driven by a combination of revenue outperformance, as well as cost benefits from lower personnel-related expenses in the quarter. As a reminder, our non-GAAP results do not include a one-time restructuring expense of \$9.7 million.

Moving to operating metrics, our two key business metrics are net dollar retention and customers contributing more than \$5,000 in ARR. As a result of the FX impact, net dollar retention was 103% on a reported basis, and we performed slightly better than our expectations at 105% on a constant currency basis. Looking forward and based on expected pressure on expansion, we estimate net dollar retention of approximately 103% on an as reported basis and 104% on a constant currency basis for Q1.

For our second key business metric of number of customers contributing more than \$5,000 in ARR, as of the end of Q4, this metric grew 11% year-over-year on an as reported basis and 13% year-over-year on a constant currency basis to 22,558 customers. This customer cohort continues to represent 90% of our ARR.

For our larger customer cohort, contributing more than \$50,000 in ARR as of the end of Q4, we saw growth of 22% year-over-year on an as reported basis and 24% year-over-year on a constant currency basis to 3,053

customers. This cohort represents 50% of ARR. For total customers, we added over 2,600 net customers in the quarter, and ended with over 72,200 customers. Approximately 2,000 of the customers are the result of our recent initiatives to improve free to paid conversions. We expect these conversions to have a slight benefit to Q1, as the majority of the conversions occurred in Q4.

Now let's turn to calculated billings, balance sheet and cash items. Our calculated billings grew approximately 23% year-over-year on both an as reported and constant currency basis to \$222.5 million in Q4. Excluding the impact of Device42, calculated billings grew 17% year-over-year. As we discussed last quarter, our calculated billings includes the reported revenue plus the change in the total deferred revenue in the quarter. In Q4, this includes a long-term deferred revenue increase of around \$600,000. That's included in other liabilities on the balance sheet.

Looking ahead to Q1 2025, our initial estimate for calculated billings growth is 13% and 14% on a constant currency basis. For the full year 2025, we expect calculated billings growth to be approximately 13% year-over-year on an as reported basis and 14% on a constant currency basis. We want to call out a few factors for the Q1 billings growth rate comparison quarter-over-quarter. This includes 2 percentage points from early renewal activity pulled into Q4, 1.5 percentage points from FX, and 1 percentage point from one-time free to pay conversion subsiding in Q1.

Moving to our cash items, we generated \$41.7 million in adjusted free cash flow for Q4, outperforming our estimates thanks to strong collection activities and continued improvements in our operational efficiencies. This resulted in an adjusted free cash flow margin of 21%, which represents an 800 basis point improvement year-over-year. As a reminder, these results do not include a one-time use of cash of \$7.3 million related to restructuring costs. For the full year 2024, we nearly doubled our adjusted free cash flow to \$153.3 million compared to the prior year.

For the full year 2025, we expect to generate approximately \$210 million of free cash flow, with approximately \$50 million in Q1 and Q2 and slightly higher amounts in Q3 and Q4. Pursuant to our previously announced program to repurchase up to \$400 million of our common stock that was approved by our Board in November 2024, we repurchased \$15.5 million of our shares in Q4 at an average price of \$15.77 per share. As a general practice, we will update our repurchase activity at the end of each quarter.

We remain committed to executing on an appropriate capital allocation strategy and delivering long-term value to our shareholders. We continue to manage and offset share count dilution by net settling vested equity amounts by using approximately \$11 million during the quarter and \$60 million for the full year 2024. Since our IPO, we have used nearly \$300 million to net settle approximately 17.5 million shares. This activity is reflected in our financing activities and is excluded from our free cash flow.

Looking ahead, we will continue to net settle vested equity amounts and expect Q1 cash usage of approximately \$18 million using current stock price levels. For the full year, we expect to use approximately \$71 million to net settle vested equity amounts. We ended the quarter with cash, cash equivalents, and marketable securities of \$1.07 billion.

Turning to our share count for Q4, we had approximately 328 million shares outstanding on a fully diluted basis as of December 31, 2024, representing share growth of less than 1% from the prior year. The fully diluted calculation consists of approximately 303 million shares outstanding, which grew less than 3% year-over-year, 22 million related to unvested RSUs and PRSUs and 3 million shares related to outstanding options. We are mindful of

share count dilution and plan to continue managing this thoughtfully with net settle activities and share repurchases into the future.

Now on to our forward looking estimates. For the first quarter of 2025, we expect revenue to be in the range of \$190 million to \$193 million, growing 15% to 17% year-over-year. Adjusting for constant currency using FX rates from Q1 of last year, this reflects growth of 16% to 18% year-over-year. Non-GAAP income from operations to be in the range of \$32.5 million to \$34.5 million and non-GAAP net income per share to be in the range of \$0.12 to \$0.14 assuming weighted average shares outstanding of approximately 307.3 million shares.

For the full year 2025, we expect revenue to be in the range of \$809 million to \$821 million, growing 12% to 14% year-over-year. Adjusting for constant currency using FX rates from Q1 of last year, this reflects growth of 13% to 15% year-over-year. Since our Q3 earnings call in November, FX rates have also changed meaningfully impacting our financial estimates. Applying currency rates from November, our full year 2025 revenue estimate would be \$5.6 million higher, or 1 percentage point higher in growth. Non-GAAP income from operations to be in range of \$131 million to \$139 million, and non-GAAP net income per share to be in the range of \$0.52 to \$0.54 assuming weighted average shares outstanding of approximately 306.4 million shares.

Our financial outlook is based on a couple of assumptions that we would like to call out. First, our forward-looking estimates are based on FX rates as of February 7, 2025, so any future currency moves are not factored in. Second, as we look to 2025 by quarter, we expect to see higher revenue growth rates in the first half of the year compared to the second half as we anniversary the Device42 acquisition. As such, and using the midpoint of the range for Q1 estimates, we expect revenue growth rates of approximately 16% and 14% in Q1 and Q2, respectively, and 11% in Q3 and Q4.

For non-GAAP operating margin by quarter and using the midpoint for Q1, we expect approximately 17%, 13%, 16%, and 19% for Q1, Q2, Q3, and Q4 respectively in 2025. This reflects an increase in cost base starting in Q2 in connection with our annual merit cycle, followed by margin improvements as we scale the business. Our results from last quarter demonstrate the strength of our business and our effective execution against our strategic priorities. We are proud of the progress we've made in driving growth and innovation, while also maintaining a disciplined approach in improving our profitability. We're excited about the opportunities ahead as we position Freshworks for long-term success.

And with that, let us take your questions. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] One moment for our first question. It comes from the line of Brent Bracelin with Piper Sandler. Please proceed.

Brent A. Bracelin

Analyst, Piper Sandler & Co.

Q

Thanks for taking the question. I guess, my first one here wanted to double click into EX. This is now a \$400 million ARR business, 20% plus organic growth rate. How are you thinking about the growth potential here as you start to anniversary Device42? Do you think you could sustain 20% plus? What's the opportunity here in EX, double click there if you could? Thanks.

Dennis M. Woodside

Director, President & Chief Executive Officer, Freshworks, Inc.

A

Thanks, Brent. So it's Dennis. We think the opportunity is huge and that our EX business is squarely focused on the mid-market and lower end of enterprise. Our ICP is a company with anywhere from 250 to 20,000 employees. And that part of the market, if you think about the IT department, you have sophisticated demands. Typically, these businesses are global. They need ITAM, they need IT ops. They need what we have. And the biggest competitor, obviously, ServiceNow, that product is very complex and requires a lot of work to get up and running, a lot of work to get value from. We hear this all the time. So those companies in that segment, they're looking for something that's enterprise grade without the enterprise complexity, and that's fast time to value and overall lower total cost.

So the reason that we had I think it was 40 plus \$100,000 wins last quarter is because that mid-market is responding, and we're starting to get a flywheel of customers that are switching, or if they were coming off of a legacy provider like an Ivanti or Cherwell, they're choosing us over a ServiceNow. So we think that market is huge just in the US alone. The mid-market as we've defined it, account for about \$10 trillion in economic activity. We think we can build a very big business there.

In terms of the product, I think Device42, we've only really been selling it with a real effort behind it in Q4. Q3, we spent building the pipeline and kind of getting all the post-merger stuff out of the way. But now we enter Q1 with a pipeline that's roughly double what we entered Q4 with. And there's a lot of interest from companies, because companies need to get a better handle on their assets. They're looking for a tool to help them on the security side as well. We think that's going to be an accelerant. And we think AI is absolutely an accelerant to that AI – to that IT business as well. So a lot of good levers to pull going into 2025. And I'm very proud of the performance in Q4. It puts us in a good place going into this year.

Brent A. Bracelin

Analyst, Piper Sandler & Co.

Q

Absolutely. And then Tyler, one quick follow up for you if I could. Great to see the 20% plus op margin milestone this quarter, even with the acquisition, how are you thinking about balancing where you invest? I know the guide implies 16% op margin next year that looks conservative, but with over \$1 billion in cash, would you consider more M&A to complement and help accelerate the product roadmap while still maintaining prudent and efficient growth model here in margins? Walk us through the thought process around the cash use of some of the investments going forward now that you've crossed over that 20% op margin milestone? Thanks.

Tyler Renwick Sloat

Chief Financial Officer & Chief Operating Officer, Freshworks, Inc.

A

Sure. Thanks, Brent. Yeah, you're right. I think we're doing really, really well on efficiency perspective this past year, just free cash flow as well as operating margin. We're going to really continue to have that theme in terms of efficiency. But we've also been really clear, we will look at opportunities – inorganic opportunities as they come up. Device42 is the first deal we've done in I think six years and the first substantial one. And we'll continue to look at those. We're clearly digesting Device42 and really trying to optimize what we can get for that.

The same time, we're going to exercise – continue to execute on our share repurchase and continue to do the net settles, which we'll use a good portion of cash this year. And we also said, when we went through kind of our restructuring in Q4 that we were planning to reinvest a lot of that into the business, really focused on making sure that we have the right people and the right places and investing for growth in a lot of areas. So I think we can do both, right? I think we can kind of make prudent investments and really kind of invest where we feel like we're going to get the biggest returns while also bringing better bottom line performance.

Operator: Thank you. One moment for our next question, please. And it comes on the line of David Hynes with Canaccord Genuity. Please proceed.

David Hynes

Analyst, Canaccord Genuity LLC

Q

Hey, good evening guys. Dennis, can you touch on the \$50,000 plus customer adds and the kind of the slowdown in the metric there? I mean, it makes me feel like maybe the IT ESM business didn't have the best net new quarter. But I realize also that metric doesn't capture upsell cross-sell of customers that may already be ahead of that threshold. So just help me kind of interpret that data point relative to the bookings that you saw on the IT side of the business?

Dennis M. Woodside

Director, President & Chief Executive Officer, Freshworks, Inc.

A

Yeah. So thanks for the question. First of all, remember we had a disproportionate FX impact in Q4. We're more FX exposed than a lot of other players because we've got around 40% of our revenue coming from Europe and about 15% from rest of world. So that's one – that affected that \$50,000 number. The second is, we were lapping in Q4 against a pretty strong prior year Q4. And that had an effect as well. And the other thing is that we are landing more larger deals but fewer of them. So we had in Q4, our most deals over \$200,000. We had a large number of deals over \$100,000, and those are both expansion and renewals. So all of those things affect just the absolute number of customers with over \$50,000 in revenue.

So if you look at the ARPA for that cohort that's actually up. And that's also something that we look at closely. So I think that this time through that metric definitely was affected by some other factors. But we're pretty comfortable with our upmarket momentum. You just look at the stable of customers that we're gathering that are sophisticated global players, like a new balance and we continue to see opportunities to press upmarket.

David Hynes

Analyst, Canaccord Genuity LLC

Q

Yeah. Yeah. That makes sense. That's a helpful explanation. Maybe as a follow up, you mentioned the Unisys partnership and maybe the opportunity to evolve that to an MSP opportunity over time. Maybe you could just

broadly touch on kind of the MSP opportunity, how meaningful that could be on the IT side of the business. And are you there from a product perspective today to support that type of customer?

Dennis M. Woodside

Director, President & Chief Executive Officer, Freshworks, Inc.

A

Yeah. So we're really excited about Unisys. I had a chance to go out and meet with their CEO in Q4. And they are a GSI. They have a large cohort of companies that are right in our sweet spot, right in that mid-market lower end of enterprise space. And those companies were coming to them looking for an alternative. And Unisys spent a year evaluating every product in the market, because they wanted to be able to build a service line around an IT product and bring it to market. And they chose us. And what we're doing now is working on a co-sell motion.

We've already had our first couple of deals that we've developed and landed with Unisys as well as building – they're going to be building an MSP around our Freshservice product. And we've been investing for a while now in the MSP functionality of our product. We have a set of releases that are coming out in May that will enhance the functionality for an MSP, things like Multi-Account Management and so forth. We already have over a thousand MSPs using the product, even though we haven't really up until recently been building functionality that's specific for MSP. So we think the opportunity there is quite large and I'm pretty excited about it.

David Hynes

Analyst, Canaccord Genuity LLC

Q

Excellent. Thank you very much.

Operator: Thank you. Our next question is from the line of Elizabeth Porter with Morgan Stanley. Please proceed.

Elizabeth Porter

Analyst, Morgan Stanley & Co. LLC

Q

Great. Thank you so much for the question. On the NRR side, the outlook still seems a little bit pressured from expansion. And just given it's been a few years that we've had that expansion pressure. I wanted to get a sense for at what point are customers kind of running lean enough and that they could start to re-expand. And also what's the opportunity for the innovation cycle that we're seeing with AI? And AI also shifting more towards monetization, become a lever to drive that expansion side to start to recover? Thank you.

Dennis M. Woodside

Director, President & Chief Executive Officer, Freshworks, Inc.

A

Maybe I'll take the second. Hey. So Elizabeth, it's Dennis. I'll take the second part and then we'll talk about NRR. I think that, that innovation cycle is really just starting to play out. We're seeing very healthy double-digit attach rates of our Freddy AI products in our SMB segment. And you saw the growth in total net adds for the quarter, best quarter in four years. A large part of those conversations now involved AI. And then we're systematically going into our customer base of 70,000 customers and selling in AI, both Freddy AI Agent and Freddy Copilot to those customers as well. So we think that there's a big opportunity there to drive growth from that segment going forward. And also we do feel we're still really early in the AI adoption cycle, but this year is the year when we're going to see that continue to accelerate. And Tyler can talk about NDR.

Tyler Renwick Sloat

Chief Financial Officer & Chief Operating Officer, Freshworks, Inc.

A

Hey, Elizabeth. So yeah, we came in at 105% [ph] on a percent (00:44:49) for net dollar retention on a constant currency. So it's actually a little bit better than what we thought. We've been talking about how we've been doing really well on churn and churn for across all products is now in the kind of solid mid-teens. That being said, we had also talked about, hey, we've been seeing pressure on our largest expansion motion, which is still agent addition. We had pressure on that for years. Now we did see the decline in the expansion rate for kind of agent additions start to kind of stop, in – kind of the back half of the year. But we still have a decline from a year – year-over-year compare. So that's kind of why we're still calling 104% for Q1. That's kind of what we see right now. If expansion insurance comes in, what we see, the way we see it.

So obviously, Dennis just mentioned on the Freddy products those are doing really well. From a monetization perspective, we still need to do some work on getting them to our existing install base. But on attach rate for new business, they're really, really healthy. Device42, we think has a lot of capacity to go into our existing Freshservice base and then our ESM offering for business agents for our Freshservice customers. These are the kind of add-on products that we're really focused on going into 2025 that are going to be the supplement to agent addition.

Elizabeth Porter

Analyst, Morgan Stanley & Co. LLC

Q

Great. And just as a follow up, I wanted to double click on the SMB side. It sounds like the improvement in net adds with a lot of execution on the free to paid conversion. So I was hoping to get just an update on the broader SMB demand environment, is the improvement that we started to hear about last quarter something that's continuing and kind of what's your outlook into 2025?

Dennis M. Woodside

Director, President & Chief Executive Officer, Freshworks, Inc.

A

Yeah. I would say, Elizabeth, that the demand is stable to improving. And I think you see that in the ARR figure for CX, where we've seen, on a constant currency basis to – two quarters of around 7% year-over-year. So I think that SMBs still are constrained in that rates for them. Interest rates are quite high relative to history. But they – but on the other side of it, they are starting to realize that AI can help and AI can help them be more efficient, more effective, especially the SMBs that are a little bit larger in the 100 to 200 employee range, where they have an IT department, they have a customer support team. So and that's really where our business is focused. So I'm optimistic for 2025. I can't give you like a completely clear single one way or the other. But we definitely were happy with the progress that we made in Q4.

Elizabeth Porter

Analyst, Morgan Stanley & Co. LLC

Q

Great. Thank you so much.

Operator: Thank you. And as a courtesy to other analysts, please, we ask that you limit your questions to one. One moment for our next question. It comes from the line of Pinjalim Bora with JPMorgan. Please proceed.

Noah R. Herman

Analyst, JPMorgan Securities LLC

Q

Hey, guys. This is Noah on for Pinjalim. Thanks for taking our question. Can you just maybe provide a little bit more color around what you're embedding in the 2025 guidance as we look at both the CX business as well as the Freshservice side of the business as well? Thank you.

Tyler Renwick Sloat

Chief Financial Officer & Chief Operating Officer, Freshworks, Inc.

A

Yeah. Hey, Noah, this is Tyler. We didn't break out between the two different products. We've been talking about, EX is still doing really well. We had a question earlier on what is the sustainability of kind of 20% growth there? And we think that's a huge market. And CX has kind of stabilized where that kind of 7% growth is what we said it was in Q4. And that's one that we've been very open about what we're doing there in terms of very focused efforts on an ICP.

When we look at the guidance for the year, the revenue guidance, clearly this is the first guidance for the years. We do – we have a lot more fidelity into Q1 than we do for the full year, and we'll clearly update it as we go throughout the year. I think the one thing that we did call out is that we are going to be annualizing the Device42 acquisition so that the compares from a revenue perspective do get tougher in the back half of the year than they are in the front.

We also noted that there's some nuances to the operating margin really around, our merit cycle in Q2 and, we would expect it to continue to drive efficiencies to the back half of the year, and that's why we expect that to go up. So we called out as much nuance as we know about right now, clearly, as we get to the end of this quarter and can reflect performance from this quarter for the year, we will update guidance for the rest of the year after this quarter.

Operator: One moment for our next question, please. And it comes from the line of Patrick Walravens with Citizens JMP. Please proceed.

Patrick Walravens

Analyst, Citizens JMP Securities LLC

Q

Oh, great. Thank you. And let me add my congratulations. Dennis, I'm curious with sort of the recent advances that we've seen on the AI front with DeepSeek. And then today, Mistral all of a sudden is ramping up to the top of the App Store list. Have you guys had time to sort of wrap your arms around what that means in terms of, what you could maybe do for your customers, which you didn't think you could do before, and also what the implications are for the costs that you guys incur when you deliver AI across the user base?

Dennis M. Woodside

Director, President & Chief Executive Officer, Freshworks, Inc.

A

Definitely, Pat. Thank you. So look, competition is good for us among LLMs. And competition has already driven pricing down and will continue to drive pricing down. We've built our tech stack so that we can and already do look at and test various LLMs as the space continues to innovate. So we rely today for conversational capability on Azure OpenAI, and that's because there are certain protections that are built in with respect to data, with respect to hallucinations, that Microsoft provides, that we find of value and then we have our own protections on top of that. But we also have tested Anthropic. We have tested Google's AI for, in particular, image. And we're always looking at other models that are out there.

We're going to balance cost, performance, data security. All those things are important to our customers. And the competition is, overall, just something that's going to help us deliver a better product at a lower cost over time. So far, all of that is good for us. All of the developments are good, and we're constantly evaluating all the models that are coming out.

Patrick Walravens

Analyst, Citizens JMP Securities LLC

All right. Super helpful. Thank you.



Operator: Thank you. Our next question is from the line of Scott Berg with Needham & Co. Please proceed.

Robert Morelli

Analyst, Needham & Co. LLC

Hi. This is Rob Morelli on for Scott Berg. Thanks for taking the question. Congrats on the quarter. Great to hear about some of the momentum with the SMB and CX. With this in mind, how do you think about your go-to-market investments for 2025? Is a larger proportion still going towards ITSM or are there opportunities to invest in CX with this recent momentum? Thanks.



Dennis M. Woodside

Director, President & Chief Executive Officer, Freshworks, Inc.

Yeah. So we balance our investments across CX and EX, depending on where we see the opportunity. We – for the CX business, that today is about two-thirds SMB.



And so we continue to invest against marketing in particular, to drive demand among the SMB community into CX. And the EX business tends to be more of a mid-market and lower-end of enterprise business, so those investments are going into field and the like. So, I think the way we look at the business, we're going to allocate investment where we see momentum, where we see opportunity and continually adjust throughout the year depending on what kind of results we're seeing.

And over the course of the last year, we've been very mindful about both the payback and the economics of all those investments to make sure that it makes sense. And you see that in terms of the sales and marketing as a percentage of revenue coming down and us continuing to drive efficiency in that sales and marketing line item.

Robert Morelli

Analyst, Needham & Co. LLC

Got it. Thanks.



Operator: Thank you. One moment for our next question. It comes from the line of Brent Thill with Jefferies. Please proceed.

Brent Thill

Analyst, Jefferies LLC

Thanks. The 50% attach for Freddy Copilot is very impressive. Is there any way to quantify the ACV uplift, what you're seeing on average?



Tyler Renwick Sloat

Chief Financial Officer & Chief Operating Officer, Freshworks, Inc.

We have not broken out the dollars yet on the attach rate in terms of quantification. And that attach rate really is to new business on the larger deals. It's a double-digit attach rate for the SMB deals. As we go about – as we go



through this year, specifically probably in our Investor Day, which is going to be at the beginning of the back half of the year, we can look to provide more kind of the monetization strategy for our Freddy products.

As a reminder, we have the Copilot, which is an add-on price to our agents, which is at \$29. But we also have our Freddy AI Agent, which is more of a consumption-based model. And that one gets monetized more as our customers use it. We also talked about how many of those customers are actually now paying customers, which is over 1,300 customers that are now paying for additional bot sessions. So again, we haven't broken out the actual dollars. I think it's still a little bit early, but the progress is really, really positive.

Dennis M. Woodside

Director, President & Chief Executive Officer, Freshworks, Inc.

A

Yeah. Just one thing to add there. If you are selling CX today, you have a number of options to drive expansion or to drive a bigger sale. You can add Freddy AI Agent to solve L1 support problems.

You can add Freddy AI Copilot, the per seat license to improve the productivity of the agents that you're serving. You can, if you're selling IT, you can provision our ESM product, Freshservice for Business Teams to address a broader set of employees within the company. Or you can bring Device42 in. So there's a lot of expansion options that we have at our fingertips now that, frankly, two years ago we didn't have that are helping us drive the business forward and helping us drive consistent growth.

Brent Thill

Analyst, Jefferies LLC

Q

Thank you.

Operator: Thank you. Our next question is from the line of Rob Oliver with Baird. Please proceed.

Rob Oliver

Analyst, Robert W. Baird & Co., Inc.

Q

Great. Thank you. Dennis, I wanted to ask on Device42 as well after your comment, and maybe a follow up to Brent's question earlier. But I know, are you seeing, in the market sort of improvement in win rates now that you guys have the opportunity to come to the table with an ITAM solution? What has that done to the competitive opportunity for you guys in ITSM? And how has it helped that? And then can you just remind us of what other deadlines or milestones we have this year to look forward to for Device42?

I know Tyler mentioned the anniversary of it, but I think there's also some technological or financial milestones that we should be aware of as well. Thank you.

Dennis M. Woodside

Director, President & Chief Executive Officer, Freshworks, Inc.

A

Yes. So let me start with the milestones. The first one was met in – earlier in January. We launched a revamped integration between Freshservice and Device42 that allows for more seamless synchronization of data across those two platforms. So I can be working in Freshservice and see data that's being pulled from Device42, which you couldn't do before. You needed to switch applications and so forth. So that was the first milestone. The second milestone is a cloud version of Device42, which, we're slating for late this year, early next year. And that's on track as well. Those are the two technical milestones to keep in mind.

In terms of the competitive dynamics, the reason that we went out and looked for an IT asset management solution was that we were losing deals in the mid-market and lower end of enterprise over functionality for IT asset management. A lot of companies, when they're buying their ITSM, want to buy their asset manager along with it. And what we've seen is that we're able to move into these larger and larger deployments.

A good example is New Balance. And New Balance came to us when we had a partnership with Device42, but we hadn't initially purchased the company. And then during the course of the kind of discussions with them, we did. And now they're implementing Device42 as part of their global solution. And that's the kind of customer that we want and that we're consistently winning now. Another one was the hard drive manufacturer that I referenced, 13-year customer of ServiceNow.

A big component of that sale is Device42. So we're absolutely seeing it as essential for our growth and for us to make that upmarket motion. And again, it's only been, remember, it's only been one quarter when we've been fully selling together.

But the fact that 3 of our largest 10 deals involved Device42 is a real positive. The fact that we enter this quarter with twice the pipeline we had last quarter, and last quarter was pretty good just for Device42 is, that's positive. And then just the, I would say, the buzz among the sales team about Device42 and the ability to bring that to market has been super positive as well.

Rob Oliver

Analyst, Robert W. Baird & Co., Inc.

Q

That's great color. Okay. Thanks a lot. Appreciate it.

Operator: Thank you. And our last question comes from Ryan McWilliams with Barclays. Please proceed.

Ryan MacWilliams

Analyst, Barclays Capital, Inc.

Q

Hey, guys. Thanks for taking the question. Tyler, how should we think about the shape of net retention for this year, as implied by the guide? And how should we think about the Device42 revenue contribution for 2025? Thanks.

Tyler Renwick Sloat

Chief Financial Officer & Chief Operating Officer, Freshworks, Inc.

A

Yeah. So we talked about net dollar retention for kind of Q1 is 104%. And we didn't really talk – give guidance for the full year. But right now we don't see anything different for the full year. And so we think it's going to be relatively consistent, clearly, as we get more fidelity on that number each quarter as expansion rates, and churn rates, as we see that we will update that. But right now I would just model it out as we [ph] get out (00:59:59) for Q1.

In terms of Device42. We actually do not plan to break out the Device42 number. As we indicated, in the script, right, 3 of the top 10 deals in Q4 included Device42 and half of the net new Device42 deals were actually sold by Freshworks teams, which means that they're sold in bundle with Freshservice.

And as such, that's a really positive indicator that the reason we did the deal is it's starting to come to fruition. It's all starting to be included as one product, one united product, and it's going to be very difficult to kind of

disassociate revenue from one to the other as we go through that. So if there's any huge anomalies, we'll call them out. But in general, we don't plan to distinguish.

Ryan MacWilliams

Analyst, Barclays Capital, Inc.

Q

Makes sense. Appreciate the color. Thanks, guys.

Tyler Renwick Sloat

Chief Financial Officer & Chief Operating Officer, Freshworks, Inc.

A

Thanks, Ryan.

Operator: Thank you. And this concludes our Q&A session and program for today. Thank you all for participating. And you may now disconnect.

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