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Freshworks, Inc. (FRSH)

Q3 2025 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, and thank you for standing by. Welcome to the Freshworks Third Quarter 2025 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. [Operator Instructions] Please be advised that today's conference call is being recorded.

I would now like to hand the conference over to your first speaker today, Brian Lan, Director of Investor Relations. Please go ahead.

Brian Lan
Director-Investor Relations, Freshworks, Inc.

Thank you. Good afternoon, and welcome to Freshworks' third quarter 2025 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 third quarter 2025 performance and our financial outlook for our fourth quarter and full year 2025.

Some of our discussion 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 our management's beliefs about our business and industry, including our financial expectations and estimates, uncertainties in the macroeconomic environment in which we operate, and market volatility, 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 assume 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, and 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.

Thank you, Brian. Freshworks delivered an outstanding Q3, marking the third consecutive quarter this year that we surpassed our estimates across growth and profitability metrics. We grew Q3 revenue 15% year-over-year to $215.1 million on both an as-reported and constant currency basis, approximately 3 points above the high-end of our previously issued estimates. Non-GAAP operating margin expanded to 21%, 5 points above our estimate. Our free cash flow margin was 27%, and we added a fifth straight quarter of Rule of 40 plus.

We ended the quarter with nearly 75,000 customers, including new logos such as global auto manufacturer Stellantis, multinational bank Société Générale, the Pennsylvania Gaming Control Board, and Travis Perkins plc, the UK's leading distributor of building materials. Our positive results also reflect significant expansion deals with existing customers like Wiley, The Access Group, and iRhythm Technologies.

In Q3, we saw a more than 40% year-over-year increase in the number of new and expansion deals with greater than $50,000 in ARR. Our strategy has focused on three key growth drivers: investing in employee experience, delivering AI capabilities across our products and accelerating adoption, and driving continued expansion in customer experience.

At our Investor Day in September, we outlined our path to $1.3 billion in ARR in the next three years, and we continue to make progress towards our goal of ESM, AI, and ITAM, each generating over $100 million in ARR.

Before we dive into the results, I want to speak to the transformative AI opportunity ahead for Freshworks. We have over 50 AI-driven applications in the hands of customers right now, and the direct monetization of these products demonstrates that we are driving incremental growth and that customers are realizing tangible outcomes from our AI.

The headline here is that businesses need the right foundation, workflow, data and security, that all work together, and that's what we provide. Companies will continue to rely on us because we have the operational context, data connections and governance needed to manage full-service functions like customer support and IT service at scale. Security, privacy and compliance are already built into our architecture. That's what makes our AI enterprise-ready compared to general purpose AI.

Employee experience continues to lead in durable growth, achieving over $480 million in ARR. That represents 24% year-over-year growth on an as-reported basis and 23% year-over-year growth on a constant currency basis, an acceleration from Q2. Three primary growth drivers that contributed to these results include: expansion into departments outside of IT, continued growth upmarket, and deepening our foothold in IT asset management with Device42.

Enterprise service management continues to be an important expansion lever as customers increasingly use Freshservice in areas of their business outside of IT. Our ESM solution, Freshservice for Business Teams, has doubled its annual recurring revenue in the past year and exceeded $35 million in ARR in Q3. Customers like Databricks, RingCentral and Qualfon are using our ESM offering to automate workflows and deliver more personalized employee experiences at scale.

As of Q3, one in every four eligible Freshservice customers are using Freshservice for Business Teams. To meet this surging customer demand, today, we announced that we are expanding Enterprise Service Management access by making Freshservice for Business Teams available as an independent product for non-IT functions. With a stand-alone product, we are no longer limited to using IT as our entry point and we can now sell directly to HR, finance, facilities and legal, even if an organization is already locked into another ITSM tool.

Second, we continue to move upmarket with midsize and enterprise customers. In Q3, ARR from customers who spend more than $100,000 with us grew 25% year-over-year. The steady flow of new product innovations like Employee Journeys, our AI-powered onboarding and offboarding capability, and increased adoption of Business Teams contributed to the momentum of these larger customers.

Freshworks is positioned as a clear alternative to legacy players, and we continue to displace incumbents. In Q3, we delivered our highest ITSM competitive win rates in two years, as customers selected Freshservice for its ease of use, fast deployment and lower total cost of ownership.

Freshworks has an established track record in ITSM. Mid-market and enterprise organizations want speed and simplicity, and Freshworks delivers. One example is HOLT CAT, the largest US dealer of caterpillar equipment, who saw significant improvement in efficiency and productivity as agents were able to handle nearly 10,000 tickets within six months and bring their average ticket resolution time to under five hours.

The third growth lever in EX is our advanced IT asset management offering expansion with Device42. In Q3, we closed our biggest Device42 new deal to-date with the largest US-based sporting goods retailer. Device42's deep integration with Freshservice and its differentiated discovery engine made it the clear choice for enterprises that are seeking real-time visibility and control. The momentum is evident as half of our top 10 largest deals in the quarter included a Device42 component.

In addition to these three growth drivers, we're deepening our presence across key verticals. For example, in Q3, we doubled our law firm customer count, reaching over 1,000. In sports, we want to congratulate the Los Angeles Dodgers, one of several Major League Baseball teams that rely on press Freshservice, on winning back-to-back World Series; and also the McLaren Formula 1 team for winning back-to-back Constructors' Championships.

Finally, we continue to drive greater efficiency and focus on our go-to-market motion. On the leadership front, we welcomed Enrique Ortegon as Senior Vice President and General Manager of America Field Sales. Enrique's experience leading high-performing sales organizations will help sharpen our execution, accelerate growth and strengthen our GTM discipline across North and South America.

Now let's talk about our AI tailwind. Freddy AI continues to be a growth driver and expansion opportunity across EX and CX, and is delivering exceptional results for thousands of customers who are seeing tangible business value and returns quickly after adoption. As we stated before, we believe this can be a $100 million stand-alone revenue stream over the next three years.

AI is becoming a core productivity engine for every team, not just for IT. And here's why Freshworks is winning. Our products sit where real work happens, in customer support, IT, HR, and operations, helping businesses automate tasks, resolve issues faster, and deliver better experiences with less effort. Our AI is deeply embedded in how our customers work every day. It's writing replies, classifying tickets, generating insights, and increasingly taking action on behalf of employees and customers.

The results speak for themselves. AI ARR has doubled year-over-year. Customers are now using Freddy AI to resolve millions of problems every week. And our new AI agents are performing real work across industries, from handling returns in e-commerce to managing employee requests in HR. As a testament to our AI momentum, we have seen AI agent usage expand more than sixfold in the past seven months, while our existing AI Copilot solutions continue to double in usage year-over-year.

Freddy Copilot ARR grew 160% year-over-year and was included in over 60% of our new customer deals over $30,000, a 5-point increase from the prior quarter. We also saw double-digit attach rates again for new SMB customers in Q3. The number of customers using Copilot grew significantly, too, by over 130% year-over-year.

Travis Perkins plc upgraded from legacy complexities to service efficiency with Freshservice and Freddy AI Copilot. Travis Perkins is now able to provide best-in-class IT service management to 17,000 employees across 1,400 locations, while improving operational execution, optimizing costs, and increasing productivity for HR and IT teams.

These Freddy Copilot customers stick with us. Their net retention rate is 112% in Q3 for both CX and EX, higher than our overall base, and a tangible sign that AI is driving deeper engagement and long-term value. We believe this tailwind will continue to strengthen our growth trajectory.

The number of Freddy AI agent sessions grew over 70% in Q3, and we have seen 650,000 sessions per month since launch. Freddy AI agent deflected more than 50% of tickets for CX and EX customers. Those who had early access to agentic workflows that we launched in June are seeing their average deflection rate jump to 65%, with a handful of customers seeing 80% of service issues resolved by AI agents.

We're seeing positive feedback from customers who have had early access in Q3 to several products we announced at our June Refresh event. For example, Gail's Bakery, a midsized UK cafe chain with over 170 locations, used Freddy AI Agent Studio for Freshdesk to build AI agents. These Freddy AI agents now handle 1,000 inquiries per month to deflect more than one-third of total volume. Employees are freed from repetitive work and can dedicate more time to more complex customer cases like allergies, ingredients or complaints that require personal care.

Next week, we'll share new product announcements across our entire portfolio at Refresh North America on November 13 in San Francisco and at our virtual summit on November 18. This includes new vertical agentic AI agents that bring our growth strategy to life, demonstrating how we're executing through AI innovation that expands our addressable market and deepens customer value.

Our third imperative, customer experience, grew to over $390 million in ARR, representing 8% growth year-over-year on an as-reported basis and 7% on a constant currency basis. Q3 growth was driven by deeper product adoption and customer sentiment that Freshdesk is easier to implement and use than the legacy alternatives.

To build momentum, we've refocused our CX products and will be announcing a new, unified experience at Refresh next week, a single workspace that consolidates Freshdesk, Freshchat and all of our Freddy AI products for customer support teams. This hub centralizes all conversations, context, and tools to help agents resolve inquiries and get work done more efficiently. This will be a force multiplier for frontline support teams, helping them improve the speed and quality of customer service.

Freddy AI continues to be an expansion driver for CX with measurable impact for customers using Freddy AI agents in Freshdesk. For example, Bergzeit, a leading German outdoor retailer, uses Freddy AI agents to automatically retrieve real-time order data and provide status updates, return label and invoices with customers in seconds. This has significantly reduced ticket volume and improved response times, driving higher satisfaction and greater trust in the Bergzeit brand.

The potential of agentic workflows is tremendous. Traditionally, building AI agents like this took months, designing customer support workflows, training data and endless testing. Our pre-built AI agents help our customers deploy on day one to handle tasks like expediting orders, processing returns or checking delivery status. That means faster setup, faster results, and a better customer experience from the start.

While SMB and commercial segments continue to turn to Freshdesk, we are also seeing larger implementations with midsize and enterprise organizations like the University of Pennsylvania, who consolidated its finance support into a single hub with Freshworks. In just six months, the university processed more than 30,000 service tickets, streamlining workflows and improving stakeholder satisfaction. We believe customers of all sizes continue to choose Freshworks CX solutions for its AI-driven efficiency and uncomplicated customer support experience.

Around the world, businesses are choosing software that delivers real outcomes: speed, simplicity, and measurable ROI. And that's exactly where we stand out. Our enterprise-grade products deliver faster time-to-value and lower total cost of ownership, aligning perfectly with what today's buyers demand. With solid momentum behind us, we're leaning into the global opportunity ahead to expand our pipeline, acquire new customers, and fuel durable growth.

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 Operating Officer & Chief Financial Officer, Freshworks, Inc.

Thanks, Dennis, and thanks, everyone, for joining on the call and via webcast today. We are very pleased that we continued our streak of outperforming across both growth and profitability during the third quarter. We once again exceeded our revenue, non-GAAP operating income and adjusted free cash flow expectations. This strong overperformance reflects the continued demand for our AI-powered and uncomplicated EX and CX solutions. Our consistent execution and financial discipline position us well to capture the significant long-term opportunities ahead.

For our call today, I'll cover the Q3 2025 financial results, provide background on the key metrics, and close with our forward-looking commentary and updated expectations for Q4 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 our adjusted free cash flow, which excludes the cash outlay related to restructuring costs. To provide greater transparency into our underlying business performance, we will also include constant currency comparisons throughout today's call.

Starting with the income statement, Q3 total revenue increased to $215.1 million, growing 15% year-over-year on both an as-reported and constant currency basis. Revenue outperformance includes a onetime $1 million contribution coming from our on-premise Device42 business. Professional services revenue modestly declined quarter-over-quarter to just over $2 million, consistent with our ongoing shift in leveraging our partner network as we scale our business.

In 2025, we saw partner involvement expand significantly across our largest deals. Partners helped to lead implementations for over half of our ARR deals greater than $50,000, a notable increase from last year, underscoring the success of our robust and growing partner ecosystem.

Our EX business accelerated in Q3, growing to over $480 million in ARR, representing growth of 24% year-over-year on an as-reported basis and 23% year-over-year on a constant currency basis. Our faster growth was driven by strength across our entire EX portfolio as we saw positive momentum in not only ITSM, but also meaningful progress in ESM, advanced ITAM and AI, each of which we believe can eventually be $100 million ARR businesses.

Our CX business increased to over $390 million in ARR, reflecting growth of 8% on an as-reported basis and 7% year-over-year on a constant currency basis. We continue to see healthy and predictable demand for our Freshdesk products.

Moving to margins. We maintained a non-GAAP gross margin of 86% in Q3 as we continue to scale our business efficiently. Our non-GAAP operating income for Q3 came in at $45.2 million, representing a non-GAAP operating margin of 21% and ahead of our prior expectations, reflecting our continued top line momentum and effective cost management.

Moving to operating metrics. Our net dollar retention came in at 105% on an as-reported basis and 104% on a constant currency basis, both in line with our expectations. Just like last quarter, Device42 represented a small drag of 60 basis points to net dollar retention. We expect Device42 retention to improve gradually as we continue to scale the business with our ITSM offering. Looking ahead, we estimate net dollar retention of approximately 105% on an as-reported basis and 104% on a constant currency basis for Q4.

As of the end of Q3, the number of customers contributing more than $5,000 in ARR grew 9% year-over-year on both an as-reported and constant currency basis to 24,377 customers. This customer cohort continues to represent over 90% of our ARR. For our larger customer cohort, as of the end of Q3, the number of customers contributing more than $50,000 in ARR grew 20% year-over-year on an as-reported basis and 19% on a constant currency basis to 3,612 customers. This cohort represents over 50% of our ARR. We have continued to move upmarket successfully.

For total customers, we added over 260 net new customers in the quarter and have nearly 75,000 customers as of the end of September 30. Given the continued success of our upmarket strategy and our focus on mid-market and enterprise customers, we believe total customer count is no longer a meaningful indicator of our performance. Starting with the release of Q1 results next year, we will discontinue reporting this metric on a quarterly basis and shift our focus to larger customer measures that better reflect how we manage the business and its trajectory.

Now let's turn to calculated billings, balance sheet and cash items. Our calculated billings grew to $224 million in Q3, representing growth of 14% year-over-year on both an as-reported and constant currency basis, matching our prior expectation on an as-reported basis and coming in ahead of our constant currency forecast of 13%.

Looking ahead to Q4 2025, our initial estimate for calculated billings growth is 17.5% year-over-year on an as-reported basis and 14% on a constant currency basis. For the full year 2025, we expect calculated billings growth to be approximately 16% year-over-year on an as-reported basis and 14% on a constant currency basis, both of which are in line with our expectations from last quarter.

Moving to our cash items, we generated $57.2 million in adjusted free cash flow in Q3, driven by continued operational discipline and strong collections. This resulted in adjusted free cash flow margin of 27%, which represents an over 5% point improvement year-over-year. For the full year 2025, we now expect to generate approximately $222 million of adjusted free cash flow, with approximately $55 million in Q4.

As a reminder, we successfully completed our inaugural $400 million share repurchase program after buying back an additional 12 million shares in Q3 at an average price of $13.28 per share. In total, we repurchased approximately 27.9 million shares at an average price of $14.35.

We continue to manage an offset share count dilution by net settling vested equity amounts. During Q3, we used approximately $15 million for that purpose. This activity is reflected in our financing activities and is excluded from our adjusted free cash flow calculations. Looking ahead, we will continue to net settle vested equity amounts and expect Q4 cash usage of approximately $12 million at current stock price levels. For the full year, we expect to use approximately $58 million to net settle vested equity amounts.

We ended the quarter with cash, cash equivalents, and marketable securities of approximately $813 million.

Turning to our share count, as of September 30, 2025, we had approximately 309 million fully diluted shares, which represents a decrease of 7% year-over-year. The fully diluted calculation includes 282 million basic shares outstanding, which represents a decrease compared to both the prior year and quarter. It also includes 24.5 million shares related to unvested RSUs and PRSUs, and over 2 million shares related to outstanding options. We remain committed to thoughtfully managing our share count dilution over time.

Now on to our forward-looking estimates. For the fourth quarter of 2025, we expect revenue to be in the range of $217 million to $220 million, growing 12% to 13% year-over-year. Adjusting for constant currency using FX rates from Q4 of last year, this reflects growth of 11% to 13% year-over-year. Non GAAP income from operations to be in the range of $30.6 million to $32.6 million and non GAAP net income per share to be in the range of $0.10 to $0.12, assuming weighted average shares outstanding of approximately 284.5 million shares.

For the full year 2025, we expect revenue to be in the range of $833.1 million to $836.1 million, growing approximately 16% year-over-year on both an as-reported and constant currency basis. Non-GAAP income from operations to be in the range of $167 million to $169 million. And non GAAP net income per share to be in the range of $0.62 to $0.64, assuming weighted average shares outstanding of approximately 293.9 million shares.

Our financial outlook is based on a few assumptions that we would like to call out. First, our forward-looking estimates are based on FX rates as of October 31, 2025, and do not take into account any impact from currency moves. As a reminder, we had a $1 million revenue benefit in Q3 related to a large Device42 deal that we would not expect to repeat in Q4.

Secondly, given our strong operating and go-to-market execution this year, we are strategically reinvesting a portion of our earnings outperformance to further build on that momentum. As such, we anticipate a onetime increase in spending during Q4 to expand our pipeline and drive customer acquisition, with a modest corresponding impact on operating margins. These planned investments are reflected in our financial outlook and position us well for continued growth.

Looking beyond Q4, we are reaffirming the long-term model we outlined at our Investor Day in September. Based on our current forecasts, we continue to expect full year 2026 revenue growth of 13% to 14%, and we remain on track to achieve GAAP profitability by end of year. As a reminder, the fourth quarter has historically been our largest bookings quarter and a good indicator for us. So we will follow our typical cadence of providing a more detailed outlook for 2026 on our next earnings call.

With that said, let me provide some additional color on our operating margin linearity for the full fiscal year 2026. We anticipate that our Q1 2026 operating margin will be slightly better than Q4 2025 and represent the low point for next year. This is driven by the strategic decision to move the timing of our annual merit increase process from April to January, as well as the reset of US payroll taxes and the start of new benefit plans. Following this Q1 low point, we project a subsequent linear ramp-up throughout the remainder of fiscal year 2026, culminating in an operating margin exiting Q4 2026 at over 23%.

Our results underscore the exceptional execution and financial discipline our global team has demonstrated throughout the year. As we get ready to close out 2025, we remain focused on continuing that momentum and thoughtfully reinvesting in our growth to capture the multitude of significant opportunities ahead. We appreciate your continued confidence at Freshworks as we execute on our strategy to deliver long-term profitable growth.

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

QUESTION AND ANSWER SECTION

Operator: Certainly. At this time, we will conduct the question-and-answer session [Operator Instructions] Our first question will be coming from Scott Berg of Needham & Company. Your line is open.

Scott Berg
Analyst, Needham & Co. LLC
Q

Hi, everyone. Really nice results here in the quarter. Dennis, I wanted to talk about the announcement today. You're selling ESM as a stand-alone solution. That's certainly not news to us that were paying attention at the Analyst Day. I just want to hear kind of, I guess, how you're thinking about that solution. Is this going to be sold with a, I guess, separate sales force now? As you're selling it stand-alone, it's going to be sold with the same sales folks that you're using? And any changes to, I don't know, pricing or, I guess, whatever the marketing message looks like around that in the stand-alone environment?

Dennis M. Woodside
Director, President & Chief Executive Officer, Freshworks, Inc.
A

Yeah. Thanks, Scott. So, first of all, we launched Freshservice for Business Teams in 2022. We had a lot of demand outside of core IT departments for a service desk solution. And that, as you know, has been a huge driver for us. We crossed $35 million in ARR. That business has doubled year-over-year. About a quarter of our customers now for – Freshservice customers now are using Freshservice for Business Teams in some way, shape or form. So it's a really strong value proposition.

And what we've seen is some prospects where they might be locked into a contract for their core ITSM with a larger incumbent. They don't necessarily want to increase their vendor dependency on that incumbent. They want to preserve optionality to potentially move to us at a later date. But they need a solution now for the teams outside of IT. And that's why we launched this. In those cases, we can sell to them now. We can preserve that optionality, get to know them a little bit. So when that contract does come up for renewal for core ITSM, we're there and they've had a positive experience with us.

There's no new sales force around this. We already have a pretty well-worn try-to-buy way of getting a lot of customers started. So all of our typical outbound and inbound marketing methodologies apply here. It's going to be the same sales force we have. So we think we'll get a lot of scale out of that. And this is on top of the core ESM business that we have, the product that is attached to Freshservice. We think that alone – when we talked about this at Analyst Day, that alone has a path to $100 million. This is additive to that.

So we're launching it today. We'll have more next quarter in terms of early traction. But we're pretty positive about where this is going to go, just given the success of the products that we've had in the market already.

Scott Berg
Analyst, Needham & Co. LLC
Q

Excellent. And then from a follow-up perspective, maybe this is for Tyler, is it's around your buyback program. It expired in the quarter. You'd certainly been buying back some shares at a higher levels. I didn't see that repeated here, which I kind of almost expected, I guess, in the quarter or at least an expansion of those efforts. Should we take that as maybe an indication or a shift in your capital allocation strategy? Or I don't know, maybe there's something more just on a timing basis there. [ph] Any details (00:32:10) that would be great. Thank you.

Tyler Renwick Sloat
Chief Operating Officer & Chief Financial Officer, Freshworks, Inc.

A

Yeah. Hey. Thanks, Scott. Yeah. So we finished the inaugural buyback in Q3. So we just finished it a month-and-a-half ago. That was authorized a year ago for $400 million, and we completed that. And we were happy to get that done. I think the weighted average price is just over $14.

We are committed to working with the board on a continued capital allocation strategy. We've always said we've been open to M&A. If that comes forward, we're obviously going to invest in the business where that's needed. But we're producing a lot of cash flow now. And we'll continue to talk about the board – about other uses of capital, including other buybacks.

We are still doing our net settles and we provided the data there. And so we're still spending money every single quarter on net settlements. And that's been outside of the buyback. So that'll be a continual discussion that we'll have with the board.

Scott Berg
Analyst, Needham & Co. LLC

Q

Awesome. Nice quarter, again. Thank you.

Operator: And our next question will be coming from Alex Zukin of Wolfe Research. Your line is open.

Q

Hi. How are you? This is [indiscernible] (00:33:16) on for Alex Zukin at Wolfe. Congrats on the great results. Can you just give us a little bit more color on how you're balancing the monetization versus adoption play with the Freddy AI suite of tools? Any way we should think about how that might change with the new agent capabilities.

Dennis M. Woodside
Director, President & Chief Executive Officer, Freshworks, Inc.

A

Yeah. So just to recap our strategy, we have a Freddy AI agent, which is a consumption-based model for CX, where our customers pay us on a per session basis. We have Freddy Copilot, which is a per seat license adder. And then we have our Freddy Insights, which is only available in the enterprise plan. So different products have different monetization levers and paths.

For AI agents, we've historically priced those based on sessions with our agentic AI agents coming out in a matter of weeks. We have revisited pricing. We're not revealing that now. But we are going to be more in line with industry pricing, which is considerably higher than where our pricing historically has been. We think that the market will support that based on what we've seen in early access, with some customers seeing up to 80% deflection rates based on their use of AI agents.

What's coming in a couple of weeks are agents that are focused on very specific verticals like fintech, like travel, logistics, e-commerce, that take action on behalf of the end customer. And we know that those interactions are quite valuable. We're not quite to the point to move to full resolution-based pricing, and frankly, neither are our customers. So the session-based pricing makes a lot of sense for where we are now. But we're always open to evolving that as our customers ask us to and as customer demand warrants. But you will see a meaningful price change with the launch of those products, which will allow us to monetize it quite well.

Q

Great. Thanks, guys.

Operator: And our next question will be coming from Patrick Walravens of Citizens Bank. Your line is open.

Patrick Walravens
Analyst, Citizens JMP Securities LLC

Q

Oh, great. Thank you. And congratulations on the third quarter in a row this year. So the big question I still get, Dennis, believe it or not, is for investors who are just looking at Freshworks, they still want to know, is it an AI winner or an AI loser? and I see lots of evidence that it should be in the winner's camp, including your $100 million targets. And what you just talked about actually is really interesting about the specific verticals for agents. But just to make it easier for people, if you're going to boil it down to two or three key points that you would make on that topic, why Freshworks is an AI winner, what are they? What would you lay out?

Dennis M. Woodside
Director, President & Chief Executive Officer, Freshworks, Inc.

A

So first of all, look, we are the system of record for our customers in IT and in customer support. We have the native workflows that they're running their business off of. And that is super important for all of what we're focused on.

The products that we ship have ready-made skills, guardrails, governance, things that our customers all need in order to run their support and IT departments, and that's what they demand. So there's a meme that, oh, everybody's going to go directly to OpenAI or to Anthropic to build their solutions. That's just not going to happen. In such complex environments as Seagate's IT department or some of these others, the customers need the AI to be integrated into their workflow. They need the security.

And we can tap into the best-of-breed models as the LLMS evolve by tapping into Anthropic for coding or Gemini for image and so forth. So we think that we're actually really well-positioned as the market evolves and as customers continue to adopt AI to succeed there.

Patrick Walravens
Analyst, Citizens JMP Securities LLC

Q

Awesome. Thank you.

Operator: And one moment for our next question. Our next question will be coming from Elizabeth Porter of Morgan Stanley. Elizabeth, your line is open.

Oscar R. Saavedra
Analyst, Morgan Stanley & Co. LLC

Q

Hi. This is Oscar on for Elizabeth. Thank you for taking my question. Congrats on a great quarter. I wanted to ask, in terms of government exposure for Freshworks, tends to be more state and local. So I just wanted to check if you have seen any impact from the government shutdown either in the form of longer sales cycles or smaller deals? And either directly or indirectly, if it has pressured any small businesses within CX? Thank you very much.

Dennis M. Woodside
Director, President & Chief Executive Officer, Freshworks, Inc.
A

Yeah. It's Dennis. So we've seen no impact whatsoever. We do not have large federal government exposure. Our government business comes from state and local entities, municipalities, universities, none of which we've seen at least any kind of change. We actually landed quite a few governments and universities this last quarter, and we've seen quite a bit of expansion there. So we really just have not seen any impact at all from the shutdown or any of the federal issues.

Oscar R. Saavedra
Analyst, Morgan Stanley & Co. LLC
Q

Thank you very much.

Operator: One moment for our next question. Our next question will be coming from Brent Thill of Jefferies. Your line is open, Brent.

Brent Thill
Analyst, Jefferies LLC
Q

Great. Thank you. Tyler, I apologize if you covered this, but this onetime investment you're talking about in Q4, can you articulate a little in more detail what that is?

Tyler Renwick Sloat
Chief Operating Officer & Chief Financial Officer, Freshworks, Inc.
A

Yeah. This is really – hey, Brent. This is kind of reflecting on the fact that we've now strung together for really, really good quarters and really see a very strong demand environment for our EX products in the field specifically. And so, because we've also done really, really well on our efficiencies this year, where we've beat our operating kind of margin goals and consistently every quarter said, hey, part of it's timing, we're going to reinvest, but just keep beating.

We actually at the beginning of this quarter did release spend specific to building pipe for EX in the field because the market opportunity is there. And we're still beating our goals, but we actually decided to release that spend for the year. It's more onetime just for Q4, not repeated. That's why we also kind of gave the linearity for operating margins for next year as well.

Brent Thill
Analyst, Jefferies LLC
Q

And I'm sorry, where does that go into reps, marketing, like what's the...

Tyler Renwick Sloat
Chief Operating Officer & Chief Financial Officer, Freshworks, Inc.
A

Oh, yeah, majority of it is marketing, and it's really pipe and demand gen efforts.

Brent Thill
Analyst, Jefferies LLC
Q

Okay. I got some good ideas. We can talk later about the campaign. It has to do with Dodgers.

Tyler Renwick Sloat
Chief Operating Officer & Chief Financial Officer, Freshworks, Inc.

A

Great.

Brent Thill
Analyst, Jefferies LLC

Q

Freddy Fresh. And just for Dennis, when you talk about that 25% growth above $100,000, it seems like the referencability is building really well. Like, what do you – what are kind of the next milestones? It's been going well. It seems like it's headed in the right direction. But what are the next kind of hurdle that you'd like to see cross where you're like, okay, we're clearly on a continued trajectory – not that you aren't. It's just like what's next – what's the next stop, if you will?

Dennis M. Woodside
Director, President & Chief Executive Officer, Freshworks, Inc.

A

Yeah. Look, I think we've got a really good sweet spot in customers ranging from 5,000 to 20,000 employees. That's where there's a ton of business out there that's looking for a solution, that is enterprise grade, that is faster time to value, that's got AI built in. And we're going to continue focusing there.

I think in terms of where we're headed, we talked in the Analyst Day about continuing to drive our EX business in the low- to mid-20s in terms of growth. You saw a slight tick up in growth on a constant currency basis this quarter. We're going to keep pressing these larger and larger deals every single quarter. For us, the attach rate for D42, that's an important metric that we look at, how many of our larger deals are including Device42.

We have a big milestone coming up in Q1 where we expect to release Device42 on cloud. Once we do that, we'll be able to tap into another segment of the market that doesn't want to go on prem with any solution. They want everything to be in cloud. It'll also make it easier for us to upsell our existing customers into Device42 as a product. That's going to be another accelerant to growth.

So we've got a lot of positive, I would say, momentum and positive accelerants to that business. And Tyler was just talking about the demand gen investment we're making in Q4. That's all going into the EX business and into AI, but that really is a huge driver for us as well. So I think EX has a lot of kind of positive momentum behind it, and we're just going to keep leaning into it every single quarter.

Brent Thill
Analyst, Jefferies LLC

Q

Great. Thank you.

Operator: [Operator Instructions] Our next question will be coming from Brian Peterson of Raymond James. Brian, your line is open.

Johnathan McCary
Analyst, Raymond James & Associates, Inc.

Q

Hi. Thank you. This is Johnathan McCary on for Brian. So I wanted to ask on some of the AI deployments in your customer base. Can you talk about the appetite for that and how that may differ between the SMB and then the more mid-market enterprise customers? I'm curious, specifically, if you're seeing that it's more important piece of the conversation in certain parts of the customer base or the SMBs versus enterprises are moving from pilots to kind of forward deployments quickly. Just I'd be curious how that differs across the different customer sizes.

Dennis M. Woodside
Director, President & Chief Executive Officer, Freshworks, Inc.

A

Yeah. So as we look at our AI paid footprint, it's actually pretty even across SMB, mid-market and enterprise. We've seen traction across all three. And different companies are in different stages of understanding AI and adopting.

In terms of products, the product that clearly is leading for us has been Copilot. That's the product that for us is both most mature functionally and, if you think from a customer standpoint, that's the first port of call where you still have a human in the loop. They still have some control. So they feel more comfortable going there first.

But what we've seen in the last couple of months is really an uptick in AI agent. And we think with the launch of our agentic capabilities in CX in particular, that's really going to take off and we're going to lean into it heavily. That plus the fact that we're going to monetize at a much higher rate than we have before. We've been, I would say, quite underpriced relative to the market when it comes to our AI agent capabilities. That, we think, is going to create a big opportunity for us going into next year.

So I think overall, the customers, there's not one vertical, there's not – it's not an SMB or mid-market enterprise issue. It's relatively even across CX and EX in terms of the monetization opportunities today. And we just think every one of our customers over time is going to need the AI that we offer. We're a little over 5,000 customers that are paying for AI now. That's just going to continue to grow. It's a core part of how we're selling now.

Johnathan McCary
Analyst, Raymond James & Associates, Inc.

Q

Very helpful. Thanks, Dennis. And then maybe one for Tyler here. It's good to see the continued strength in EX, the slight acceleration there. Just hoping, can you unpack the growth algo a little bit in terms of what's trending, how ARR is trending there versus net new, and kind of where you think that should head longer term as you look to continue the low-20s growth profile? Thanks, guys.

Tyler Renwick Sloat
Chief Operating Officer & Chief Financial Officer, Freshworks, Inc.

A

Yeah. I mean, we're growing across all segments of the business, right? We talked about how ITSM core is strong, but also ESM that we gave out the number of over $35 million now, Device42 we've talked about as well, and then the Copilot components within there.

If you look at how that's going to trend, you asked about NRR, our EX products have always had strong NRR. Device42 is a little bit of a drag because of the stuff we inherited when we made that acquisition. But we also said, hey, we expect that to actually start coming up. And we've also said that EX has kind of always had enterprise-grade net dollar retention numbers – oh, I'm sorry, churn numbers, which is high-single digits. And that continues. And it's just a very, very strong product.

Operator: And our next question will be coming from Rob Oliver of Baird. Your line is open, Rob.

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

Q

Great. Hi. Good afternoon. Thanks for taking my question. Dennis, I wanted to go back to the ITSM win rates that you called out, I think the best in two years, and that's also coming I think as you've really pivoted the business up towards that mid-market or upper end of mid-market.

I just wanted to get a sense from you for kind of what the biggest key differentiators have been there in terms of repositioning for that opportunity. And then as you look at kind of your pipeline today, how you feel about the pipeline as it sets up relative to the competition? And kind of what's winning when you go head-to-head with some potentially bigger players at the low end of their stack? And then I had a quick follow-up question.

Dennis M. Woodside
Director, President & Chief Executive Officer, Freshworks, Inc.

A

Yeah, sure. So, look, what we've built over the last couple years is a complete enterprise-grade solution for – that helps an IT department drive their operations, power their operations, and deliver great employee service. And that's what we're selling, that's what's working in the marketplace.

So enterprise-grade product has the kind of security and extensibility that you'd expect and that can work in a large account, the kind of extensibility outside of core ITSM. That's why Device42 is super important for us. Typically, buyers are looking for their ITSM and their asset management solution all in one. That's what we provide now. The functionality outside of IT, that's also something that everybody looks for when they're making these decisions.

And two years ago, two-and-a-half years ago, the product wasn't there. So a lot of this momentum has happened relatively recently. A lot of customers are looking for choice in that market. There hasn't been a lot of choice The largest provider is very focused on the biggest customers in the market or the biggest companies in the market. And that leaves a lot of room for us to compete in that kind of lower end of enterprise, upper end of mid-market.

Think of New Balance with 5,000 or 6,000 employees, or Seagate with 20,000 employees, or we had a customer this time through Flowserve with about 20,000 employees. These are sophisticated customers. They've got sophisticated IT departments, but they're looking for something that's more modern, more flexible, enterprise-grade, AI built-in, and that's what we have.

So I think we're just going to continue to invest in our capabilities and functionality there. We've got our customer advisory board next week. We've got 40 customers coming in. And we're going to hear from them on what – share our road map, talk about what can we do to move faster to solve more of their needs. We got a lot of ideas last year at our CAB that we put into practice and launched an innovation that has delivered and that has helped us continue to move upmarket.

And then at the same time, the whole go-to-market side of things has matured as well. That's why we're confident in investing more in Q4 in demand gen, because we have a much better sense for how investment in demand gen connects to actual return. And we feel if we do that now, we'll just get a head start on Q1, because we've got a really good pipeline going into the last quarter.

In terms of the pipeline, I would say that when we look at – when I looked at pipeline, let's say, 18 months ago, $100,000 deal was a big deal and we made a big deal about it. Now we have tons of $100,000 deals. That's not an unusual deal anymore. The bigger deals are $0.5 million lands.

And the other thing is that we would be invited into those $0.5 million RFPs two years ago, and we would often lose. And we win the $100,000 deal or the $30,000 deal, we'd lose the $500,000 [indiscernible] (00:50:00). This last quarter, I can't recall a deal over $200,000 that we're involved in was a loss. Now, it may have happened, but nothing that I was involved in was a loss. So I think we're just getting better at competing and winning for those larger deals. And the capability is there, the functionality is there. All that's a winning combination for us.

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

Q

Great. That's really helpful. Thanks, Dennis. And then, Tyler, I apologize if you touched on this at all, but that revenue retention number has kind of really stabilized in that kind of 104% to 105% range on a constant currency basis for the last three quarters. And you guys are getting some market momentum, I realize trailing indicator. But how you think about that kind of leveling off and potentially starting to improve and what kind of visibility you have into that?

Tyler Renwick Sloat
Chief Operating Officer & Chief Financial Officer, Freshworks, Inc.

A

Yeah. We're pleased with the progress we've made there both on the expansion products we've entered – introduced. And we think ESM is going to be a new land, but then have a much bigger expansion opportunity once we start landing that with that, if we can bring in Freshservice, but obviously with Device42 and others, and on what we've been doing on churn.

We've been talking about churn for a year now, how we've just been getting a little bit better incrementally, and that's not something that moves really quickly. We guided so essentially the same amount, for Q4, which is stable. And obviously at the end of the year, based on what we learned this quarter in terms of expansion, the pipe will guide for next year. But, yes, I feel like it's heading in the right direction.

And then we've been talking about this. As the mixed shift of our business continues to move more towards EX. And that is the majority of our business now. The attributes of that business are much better. And we will get a tailwind from that at some point.

Operator: And this concludes today's conference call. You may disconnect.