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Freshworks, Inc. (FRSH)

Q1 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and thank you for standing by. Welcome to the Freshworks First Quarter 2023 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 is being recorded.

I would now like to hand the conference over to your speaker today, Joon Huh, Vice President of Investor Relations. Please go ahead.

Joon Huh

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

Thank you. Good afternoon and welcome to Freshworks' first quarter 2023 earnings conference call. Joining me today are Girish Mathrubootham, Freshworks' Chief Executive Officer; Dennis Woodside, Freshworks' President; and Tyler Sloat, Freshworks' Chief Financial Officer. The primary purpose of today's call is to provide you with information regarding our first quarter 2023 performance and our financial outlook for our second quarter and full year 2023.

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 Freshworks' current expectations and estimates about business and industry, including our financial outlook, macroeconomic uncertainties, management's beliefs and certain other assumptions made by the company, all of which are subject to change. Such risks include, but are not limited to, our ability to sustain our growth to innovate, to meet customer demand, and to control costs and improve operating efficiencies.

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. For a discussion of 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 our 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 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 earning 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 Girish.

Rathna Girish Mathrubootham

Chairman, Chief Executive Officer & Founder, Freshworks, Inc.

Thank you, Joon, and welcome, everyone. Thank you for joining us today on Freshworks' earnings call covering our first quarter of 2023. We started the year off strong, achieving our first quarter of non-GAAP operating profit as a public company. We exceeded our expectations for Q1 with revenue coming in above the high end of our financial outlook range at $137.7 million, and we outperformed our estimates for free cash flow at $9.1 million in Q1, as we drove meaningful efficiencies in our business.

In today's environment, as businesses are seeking efficiencies in their software spend and seeking faster time to value, I'm excited to see the Freshworks value proposition resonate even better with larger companies.

Before diving into our business drivers, I should note that starting this quarter, we are providing supplemental slides of some of our financial results. These slides can be found on our Investor Relations website and we hope you find them to be useful.

During these uncertain economic times, we are committed to sustaining growth through four key strategies that I outlined last quarter. First, our focus on product innovation continues to allow us to meet customer demand for efficiency, by streamlining IT processes, enhancing omnichannel customer experiences and launching an AI-powered Freshmarketer beta program. Second, we are experiencing strong growth from mid-market enterprise customers, which Dennis will discuss further after this. Third, our focus on expansion and helping our customers adopt more of our solutions continues, and Dennis will elaborate on this. Finally, we are dedicated to improving our operating efficiency. As I mentioned, we delivered our first quarter of operating profit on a non-GAAP basis since becoming a public company. Tyler will cover this in more detail later.

Beginning with our latest product innovation, this quarter, our teams launched enhancements in our CX, ITSM and CRM products that give our customers even faster time to value, freeing up agents to do their most rewarding work. Starting with ITSM, to Freshservice team has been working hard to expand its IT operations management capabilities. Last year, we added support for Microsoft Teams and WhatsApp, allowing customers to receive on-call notifications on those channels. To date, there have been over 1 million alerts per month, highlighting the success of our service and monitoring and alert management capabilities. One notable customer, FILA, a global sportswear manufacturer, chose Freshservice for its ease of use and configuration.

In Q1, we also added new capabilities for workflow automation and workload management in Freshservice. The workflow automation feature helps businesses digitize their workflows and automate repetitive tasks. The workload management feature provides supervisors with full visibility of assigned work, assists in workload monitoring and helps prevent employee burnout.

Freshservice has also expanded its services beyond IT teams with the launch of Freshservice for Business Teams. Notable customers using Freshservice for Business Teams include Brunel University in the UK and the Commercial Bank of Dubai. Freshservice's commitment to providing cost effective solutions with enterprise grade capability makes it a strong contender in this market.

In our CX business, Tata Digital turned to Freshdesk as a cost effective solution for their super app, aiming to scale support for over 1 billion potential users in India. In just six months, Tata Digital achieved a 50% ticket deflection and a 50% increase in customer satisfaction. With Freshdesk, another customer, Riverside Insights, was able to improve agent productivity by tracking real-time ticket trends, leading to an 80% reduction in logging related tickets and improved customer satisfaction. Additionally, our Q1 release of the unified agent workspace in Freshchat enables agents to work efficiently across channels. And our self-service bot experiences provide intelligent inquiry deflection.

Turning to our enhanced conversation widget, over 1,500 early adopters are already using this with more than half deploying bots. Purplle, a leading beauty destination in India, adopted Freshdesk for a unified customer support solution. By leveraging our GPT features, Purplle achieved an impressive 95% first call resolution rate. As we continue to innovate, we are dedicated to empowering businesses like these to provide exceptional customer experiences.

Now turning to our CRM business, our focus in Q1 was on enhancing sales sequences and enabling cross-channel personalized marketing campaigns to help marketers boost customer engagement. We have upgraded our Freshsales [ph] pamphlet (00:08:32) with an embedded e-signature feature, expediting the [ph] deal to quote (00:08:36) process for our sales teams.

In response to marketers' demand for better e-mail performance, we have integrated GPT-powered Freddy AI into our Freshmarketer marketing automation platform. This powerful Freshsales/Freshmarketer combination is driving significant results for our clients like Evans Manufacturing, a plastics manufacturer. After implementing both solutions, they witnessed a 3x increase in the e-mail open rate, over a 200% surge in sales activity and a substantial rise in revenue.

The Freshworks Neo platform is the driving force behind our innovative product, streamlining app development and unifying customer data analytics across Freshworks' products. This summer, in our product launch, we'll have more to share about our platform with new AI capabilities.

Freshworks' products are proving to be a powerful alternative to legacy healthcare providers. Our products are offering more flexibility and helping customers avoid the pitfalls of cumbersome implementation and unnecessary features. Whether it's for a super app or fashion footwear, we believe our solutions are the future of app development and business growth.

Lastly, before turning it over to Dennis, let me also take the opportunity to announce that we will be holding our first Investor Day on September 7 in San Francisco. Please save the date as we will send out more details later. We look forward to seeing you there.

Now, over to Dennis to talk about what we are seeing in the market, how larger customers are driving our business growth and how customers are expanding using our product.

Dennis M. Woodside

President & Director, Freshworks, Inc.

Thank you, G, and thanks to all of you for joining us. We're really pleased with our first quarter performance as we once again beat our financial estimates for revenue and improved our operating efficiency to achieve our first quarter of non-GAAP operating profit as a public company.

We surpassed our targets by focusing on new business growth, especially with larger customers, expanding with our existing customers, and making strategic investments and enhancements in our field and go-to-market teams. This focus drove continued multi-product adoption, higher participation in competitive deals, and more new business opportunities for both CX and IT. Our ability to build software at a lower cost allows us to deliver a low total cost of ownership, and thus, offer a higher return on investment to the customer.

In Q1, our products continue to show they can scale to support thousands of mid-market and enterprise customers. These customers need a sophisticated level of support, but are hungry for simpler implementation than some of our biggest competitors provide.

Looking at our large customer cohort, which we define as customers spending more than $50,000 in ARR, it grew 30% year-over-year to 2,013 customers in Q1 or 33% in constant currency. These customers, which represent 45% of our business, are choosing Freshworks over larger established players and legacy on-prem solutions.

It's incredible to see how very different companies are finding rapid impact and lasting value with Freshworks. A large company like S&P Global needed its support team to respond to customer queries as quickly as the market changes. S&P mines billions of data points to offer independent ratings, benchmarks and analytics. It then offers critical information to companies, governments and individuals to make investment decisions. S&P uses Freshdesk to automate, route and assign tickets to agents who can resolve issues fast for its 13,000 customers. S&P's ticket resolution is now four times faster than the industry benchmark, and ticket assignments happen twice as fast as the industry average.

Turning to our expansion motion, I'm encouraged to see that our customers are realizing value in one Freshworks product and growing their appetite for more through seat increases, additional products and upgrades. In Q1, our net dollar retention rate was 108% on a constant-currency basis, coming in slightly better than we expected.

Travel Counsellors is a multi-award winning travel agency with over 2000 individual travel companies known as TCs. TCs bring their own book of business and contracts and collaborate dynamically with each other. This required a faster, more efficient system to provide dependable service experience for TCs. Since 2017, Freshdesk has helped streamline, automate and prioritize support requests to provide timely help, enabling TCs to provide a great service experience. Average first contact resolution is now over 75% and average CSAT is now more than 90%. More recently, they added Freshsales for their TCs to manage new leads, recruit new counsellors and convert corporate travel opportunities.

The publishing industry is always facing pressure to be more efficient with fewer resources. Global online and print publisher, Forbes, was held back by a homegrown employee support tool, making their IT service less efficient. While looking for alternative solutions, they discovered Freshservice to streamline all employee service requests which has helped the team save costs and cut their average resolution time in half in two years.

Since then, Forbes added Freshdesks' omni-channel customer support software. In Q1, customers using more than one product remained steady at 24%. Customers come back for more than one product because of the consistency of our core attributes across the entire suite. Great design, experience and performance with minimal upfront investment allows us to deliver great value to our customers. What's significant for us is that even in this uncertain macro environment, our new business momentum has been able to offset some of the expected slowdown in expansion. This means we don't have to focus just on maximizing value from existing customers like some of our competitors.

While legacy SaaS companies may be facing challenges for new deal activity, we're encouraged by the traction our products are gaining in the market as we land new customers like Johnsonville, the L.A. Dodgers, and expand with others like [ph] Travel Counsellors (00:15:22) and Forbes.

Lastly, because of the investments we've already made in our go-to-market operations, we're not expecting to see meaningful cost increases in order to continue this momentum. As we evolve and target larger customers, we're getting more leverage from our go-to-market operations. We're also finding more areas across the board to scrutinize and reduce spend.

We expect to continue creating this operating leverage going forward. And as a result, our plan is to deliver a positive non-GAAP operating profit for the year. We're starting to see the promise of building a durable [ph] NDA-based (00:15:58) software company that utilizes our strategic asset of lower cost operations.

Before turning it over to Tyler to talk through the financial details and how we're driving these efficiencies, I want to highlight the appointment of Paddy Rathinam as our Chief Revenue Officer that we announced earlier today. Paddy has held the interim title for the past several months and has done a fantastic job and he's had a meaningful impact on our business over the years. In addition to Paddy, I'm also pleased to welcome a number of other talented leaders and new team members to Freshworks.

Now over to you, Tyler.

Tyler Renwick Sloat

Chief Financial Officer, Freshworks, Inc.

Thanks, Dennis, and thanks again to everyone for joining us. As you've heard from our earlier commentary, Q1 was a great quarter of execution. We beat our estimates for revenue and more significantly, we improved our operating margins to position the business for sustainable and profitable growth in the years ahead. I'm pleased with our ability to adjust our operating model to meet the realities of the current market environment and generate a meaningful level of outperformance in the quarter. For our call today, I'll cover the Q1 financial results, provide background on the key metrics and close with our forward-looking commentary and expectations for Q2 and the full year 2023. Similar to prior quarters all include constant currency comparisons for certain metrics to provide a better view of our business trends. As a reminder, most of our discussion will be focused on non-GAAP financial results, which exclude the impact of stock-based compensation expenses, payroll taxes on employee stock transactions, amortization of acquired intangibles and other adjustments.

Starting with the income statement. Revenue grew 23% year-over-year on a constant currency basis or 20% as reported to $137.7 million. Currency rates for the dollar against the euro and pound were relatively stable in Q1. So the different growth rates represent the trailing negative impact to revenue from FX movements mainly from prior quarters.

Despite a tighter spending environment from companies, we continue to see momentum in new deal activity for our CSM product, Freshservice in the field. Our larger deals, over $50,000 in ARR were once again the fastest growing segment for new business in the quarter. Expansion activity for the quarter performed roughly in line with our expectations as agent additions continue to be affected by a slower growth environment. In terms of churn, we achieved a slightly better churn rate in Q1 with improvements coming from both smaller and larger customers in the quarter.

Turning to margins. We had another strong quarter of non-GAAP gross margins of 83% as we efficiently scaled the business. In Q1, we achieved a positive 3% non-GAAP operating margin which represents a 5% improvement quarter-over-quarter. This is driven by a number of ongoing changes we're making to improve our cost structure and better align our operating model to support the business.

Specifically, we are scrutinizing the new hire process coupled with enhancing our performance management culture which resulted in fewer new employees and some employee exits. We're also consolidating or reducing [indiscernible] (00:19:15) go-to-market and G&A functions to match our changing needs and reevaluating all our sources of external spend for software, contractors and other areas. All of these resulted in a decrease of total non-GAAP operating expenses by $2.3 million compared to Q4.

Our revenue outperformance combined with a lower cost base led to non-GAAP operating profit of $3.9 million in Q1. This is a meaningful beat on our non-GAAP profitability for the quarter and positioned us for margin improvement for the full year.

Let me now turn to our operating metrics. Our net dollar retention was 108% on a constant currency basis or 107% as reported. This metric came in slightly better than our commentary from the prior quarter and was driven primarily by the churn improvement I just mentioned. The biggest driver of our expansion revenue continues to be agent additions. Therefore, as companies continue to reduce their hiring needs, we expect this to impact our expansion bookings. We have previously called out that we expect to see a slight uptick in churn coming into 2023. Although we saw churn improve in the first quarter, we are seeing some risk going forward. Given both factors, we estimate Q2 constant currency and reported net dollar retention to be approximately 105% with net retention rate stabilizing in the second half of the year.

Moving to our customer metrics. Customers contributing more than $5,000 in ARR grew 18% to 18,441 customers in the quarter and represent 87% of our ARR. On a constant currency basis, this cohort grew 19% year-over-year. For larger customers, contributing more than $50,000 in ARR, this customer count grew 30% year-over-year to 2013 customers and now represents 45% of our ARR. Adjusting for constant currency, this cohort grew at 33%. Lastly, we ended the quarter with a total customer count of more than 64,900 and a higher average revenue per account compared to the prior quarter.

Now, turning to calculated billings, balance sheet and cash items. In Q1, calculated billings grew 21% year-over-year on a constant currency basis or 18% as reported to $152.6 million. Other factors that impacted billings growth for the quarter were timing duration and revenue reserves, each having approximately negative 1% impact. Adjusting for these factors, normalized calculated billings growth was approximately 23% in Q1.

Looking ahead to Q2 2023, our preliminary estimate for calculated billings growth is 17% on a constant currency basis and, as reported, using current FX rates. For the full year 2023, we expect calculated billings growth to be similar to our expected revenue growth for the year of approximately 17%.

Moving to our balance sheet and cash items. We maintained a similar cash balance compared to Q4 as we ended the quarter with cash, cash equivalents and marketable securities of approximately $1.15 billion. In Q1, we generated $9.1 million of free cash flow, coming in well ahead of our estimates, and reflective of the efficiency improvements we've made in the business. We continue to net settle vested equity amounts and use a little more than $12 million in financing activities, as this activity is excluded from free cash flow.

We plan to continue net selling invested equity amounts resulting in Q2 cash usage of approximately $17 million at current stock price levels. Given the operating leverage we are creating in the business, we are increasing our free cash flow estimates for the full year 2023 to approximately $20 million. We do have some seasonality and spend throughout the year, so we expect free cash flow of approximately $3 million in Q2 and Q3 with the remainder in Q4.

Turning to our share count for Q1. We had approximately 324 million shares outstanding on a fully diluted basis as of March 31, 2023. The fully diluted calculation consists of approximately 291 million shares outstanding, 31 million related to unvested RSUs and PRSUs and 3 million shares related to outstanding options.

Let me now talk about our forward-looking estimates. As usual, I'll go through the numbers first and then provide background commentary afterwards. In the second quarter of 2023, we expect revenue to be in the range of $140 million to $142.5 million, growing 15% to 17% year-over-year. Adjusting for constant currency, this reflects growth of 16% to 18% year-over-year. Non-GAAP loss from operations to be in the range of negative $2 million to breakeven. And non-GAAP net income per share to be in the range of 0 to positive $0.02, assuming weighted average shares outstanding of approximately 291.9 million shares. For the full year 2023, we expect revenue to be in the range of $580 million to $592.5 million, growing 16% to 19% year-over-year.

Adjusting for constant currency. This reflects growth of 17% to 19% year-over-year. Non-GAAP income from operations to be in the range of positive $2 million to $8 million and non-GAAP net income per share to be in the range of positive $0.08 to positive $0.12, assuming weighted average shares outstanding of approximately $298.2 million.

A couple of items to call out in terms of how we were thinking about the year. First on FX rates, the dollar trends largely stabilized in Q1. So there was little impact to the results compared to the prior quarter. However, on a year-over-year basis, we still saw negative impact. These estimates are based on FX rates as of April 28, 2023. So any future FX moves are not factored in. At the beginning of the year, we started a hedging program for our INR-based expenses. The impact to our operating expenses was minimal in Q1, and our objective is to improve predictability for operating expenses as we go forward. Second on operating profit, I'm pleased with our ability to deliver non-GAAP operating profit just one quarter after delivering sustainable free cash flow and two quarters ahead of our prior schedule, allowing us to meaningfully raise full year estimates for profitability on a non-GAAP basis. We have our annual merit cycle that impacts Q2 expenses. But after that, we expect to generate non-GAAP operating profit in the second half of the year with Q3 at roughly breakeven in Q4 at approximately $2 million.

Let me close by saying we had a really good quarter of execution to start the year. We continued our rapid pace of product innovation. We won meaningful deals around the world and we made a number of changes to the business that we believe will drive durable and profitable growth. We're excited and look forward to our many opportunities ahead.

With that let us take your questions. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. At this time, we'll conduct a question-and-answer session. [Operator Instructions] Our first question comes from the line of Elizabeth Porter from Morgan Stanley. Your line is open.

Ryan Bressner
Analyst, Morgan Stanley & Co. LLC

Q

Hi. Thanks for taking my question. Ryan Bressner on for Elizabeth. I'm just thinking about the results for the quarter, they're fairly strong even despite a difficult macro. I'm just kind of curious what you're seeing around the consolidation theme in the market. Are you seeing more customers consolidate their platforms onto your systems or what's driving some of the factors you're seeing here?

Rathna Girish Mathrubootham
Chairman, Chief Executive Officer & Founder, Freshworks, Inc.

A

Hey, Ryan. This is Girish. I'll take that. Overall, I would say, there's no significant change compared to the previous quarters. Clearly, we are seeing customers scrutinizing their spend, like if I can speak from Freshworks experience, we looked at all the software that we bought and used and I think every company is going through that and seeing if they could get stuff done with fewer vendors. So that could be something of that. And we have several anecdotal customer examples that kind of replaced two or three tools, but that is being our play in general, so I wouldn't call out anything specific to this quarter, but overall, businesses looking to seek more value and we are benefiting from that.

Ryan Bressner
Analyst, Morgan Stanley & Co. LLC

Q

Thanks. Helpful. Maybe with the recent banking crisis in [ph] mind (00:28:43), I was curious if you've seen any difference in customer performance by vertical or maybe even region with the US underperforming or outperforming Europe and APAC?

Rathna Girish Mathrubootham
Chairman, Chief Executive Officer & Founder, Freshworks, Inc.

A

No, I think we've not...

Dennis M. Woodside
President & Director, Freshworks, Inc.

A

Sorry. This is Dennis. Just wanted to answer that one. We didn't see any appreciable difference in performance by region. We continue to see the similar trends to what we saw last quarter with SMB being a little bit weaker and our mid-market business being quite good. And you see that in our numbers in terms of the number of customers that are over 50,000 continuing to grow at strong rates.

Ryan Bressner
Analyst, Morgan Stanley & Co. LLC

Q

Great. Thanks for the question.

Operator: Thank you. One moment for our next question. Our next question comes from the line of Brent Thill of Jefferies. Your line is now open.

Brent Thill
Analyst, Jefferies LLC

Q

Thanks. Tyler, just in terms of what you're embedding in the guide, can you just give us a sense of [indiscernible] (00:29:59) the environment stable, better, how are you embedding for the year in terms of guide, what are the underlying assumptions here?

Dennis M. Woodside
President & Director, Freshworks, Inc.

A

Yeah. Hey, Brent. So there's a couple of things. One, we do expect to see some continued pressure on the expansion motion. In Q1, churn actually came in better than we expected. We had talked to at the end of Q4 that we expected to see a little bit of pressure on churn. We do think that's going to happen a little bit in Q2. We talked about net dollar retention going down to [ph] 105% (00:30:30) from where it was in Q1, which is a little bit better than what we thought at [ph] 108% (00:30:34).But we think it's kind of -- we expect it to kind of plateau at that point.

In terms of the guide for Q2 on revenue and then on billings, which we expect to kind of match revenue at around 17%, we're really just trying to call as we see it. We don't have as much visibility as a large enterprise software company of our sales cycles. And so we are just trying to be as transparent as possible from that perspective. I do think there are some really good things going on in new business growth and we are still expanding with our customers. But as agent additions is our biggest form of expansion still, that has slowed down and we've been talking about that for almost a year now. On the efficiency side, we're going to continue to drive efficiencies. We were able to raise considerably on the operating profit and on cash. And we're going to plan to execute against that for the rest of the year.

Brent Thill
Analyst, Jefferies LLC

Q

And to Dennis' comments about SMB weaker, was that weaker than last quarter or is that just kind of the same weakness you haven't seen a drop anymore kind of thinking?

Dennis M. Woodside
President & Director, Freshworks, Inc.

A

No. No change, no change from last quarter.

Brent Thill
Analyst, Jefferies LLC

Q

Okay. And then just one quick follow-up for Girish on AI. When you think about inventing ChatGPT, how long does it take to actually get embedded? When can customers start to appreciate the differences in the products? Is this a couple of quarters out, is this going to take a year? How long does it take to hit production for the point where you'd like to see it have full-scale adoption?

Rathna Girish Mathrubootham
Chairman, Chief Executive Officer & Founder, Freshworks, Inc.

A

So, Brent, we've heard before ChatGPT also in terms of steady offerings, in terms of what we already have like some of the stuff that we all saw in terms of helping our users get better content, summarizing content and all of that stuff, the OpenAI-based ChatGPT stuff, a lot of it is already out. But we are excited and actually investing right now, which is a priority for us like in this quarter and the coming quarters is how do we actually use generative AI to think about improving our ability to help businesses deliver better customer experiences and better employee experiences. So we are thinking along the lines of, hey, how can generative AI help customers self-serve themselves? How can it help customer service agents solve customer problems. Are leaders actually getting better insight? We're doing this across not just our CX product, but also across our IT and sales and marketing products. So we have a list of announcements coming up in our June product launch event. We'll share more in that. I hope you can join us.

Brent Thill
Analyst, Jefferies LLC

Q

Thank you.

Operator: Thank you. One moment for our next question. Our next question comes from the line of Pinjalim Bora of JPMorgan. Your line is now open.

Pinjalim Bora
Analyst, JPMorgan Securities LLC

Q

Great. Hey, guys. Congrats on the quarter. Great to see the operating leverage. Maybe help us understand where are we in terms of just completing some of these efficiency levers that you're pulling? How much of the low-hanging fruit still remains? And I heard there were some exits. I think you said on the sales side, how are you thinking about kind of sales capacity going forward?

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

Hey, Pinjalim. This is Tyler. Yeah, we made some changes coming into the year, but a lot of the go-to-market changes we started doing at the end of Q4 and it kind of went into effect at the beginning of January. And then the other changes that I alluded to were really kind of a three-fold, one, really focusing on performance-based culture which did result in some exits, really looking at hiring and being very focused on making sure we have the right people in the right places. And then, three, there's still employee attrition, although employee attrition has gone down.

As a result, we did end the quarter with a slightly lower head count than we had entering the quarter. But the efficiency exercises are going to continue, right? I think that we have the advantage that, number one, we have been hiring really rapidly through kind of the beginning of second quarter last year. And we really started to slow that down; two, it's kind of just one of the competitive advantages that we have with a lot of our functions really being run out of India. And the DNA of the company has always been kind of about being efficient and that we're just getting back to that and making sure we're trying to drive that efficiency.

In terms of the sales side, we feel that we are structured now. We have this one quarter of some of the changes and the capacity is there. We are still hiring reps where we feel that we need to build capacity out and we're still going to continue to tweak things to make sure we can get as much return as possible for those dollars that we're throwing into the go-to-market motion.

Pinjalim Bora
Analyst, JPMorgan Securities LLC
Q

Yeah. Understood. Okay. Thank you for that. And one for Girish. Obviously, you're starting to add a lot of the AI capabilities that we have with OpenAI and ChatGPT and all that stuff. I want to ask more of a high-level question of introduction of AI and driving efficiency potentially could have pressure on seats. So I'm thinking how are you kind of balancing the potential to capture incremental value from these efficiencies versus any potential pressure on seats that you might see in the future?

Rathna Girish Mathrubootham
Chairman, Chief Executive Officer & Founder, Freshworks, Inc.
A

Yeah. Pinjalim, this is a journey that is not new. But definitely, the question is being asked louder after ChatGPT. But in 2016, we embarked on this journey where we foresaw a future where the industry is moving more towards bots and automation. And I think the reality of let's take our biggest market which is customer service and support, the reality is a Level 1 support always will have a lot of deflection and automation and the higher order support will actually always require some amount of human touch, personalization and subject matter expertise. So I think we are just seeing more and more automation if and when that it's possible. So we already have [ph] bots (00:37:34) as part of our steady offering where we charge for that, not like based on the number of bot sessions used or based on the number of interactions. And we also have our primary agent-based model. So I think both will exist. The more automation will drive, so we will add more value to customers and be able to charge more for the bot-based automation.

Pinjalim Bora
Analyst, JPMorgan Securities LLC
Q

Understood. Thank you very much.

Operator: Thank you. As a reminder, given the number of analysts that we have on the call, could you limit to one question and then get back in the queue if you have additional questions. Thank you. One moment for our next question. The question comes from the line of Adam Bergere of Bank of America. Your line is now open.

Adam Bergere
Analyst, BofA Securities, Inc.
Q

Hey. Thanks for taking my question. So it sounds like there's solid traction as you move upmarket and you've kind of cited some pretty big customers such as the S&P or Forbes. [indiscernible] (00:38:43) might actually consider just [indiscernible] (00:38:44) enterprises. So I wanted to know where do you draw the line in terms of large customer as you actively target in an outbound manner versus some who are large and you kind of get pulled into those deals. Thank you.

Dennis M. Woodside
President & Director, Freshworks, Inc.
A

Yeah. Thanks, Adam. This is Dennis. So our ideal customer profile today is up -- about up to a 5,000 employee company, although we do stretch up into 10,000, and in some cases bigger than that. We handle all companies coming in, and this is new this year of up to 500 employees through our inbound motion, and that's primarily served out of India. So it's a rather low-cost motion, more product-led growth. And then companies that are over 500 employees are handled by our field teams. And you're correct. We have had some good progress in moving upmarket. One of the big changes we made this year is focusing our field sales teams on winning bigger deals and splitting our hunting motion from our farming or account management motion. So we have sellers whose job is 100% focused on acquiring new business and sellers whose job is 100% on upsell. We see early signs that that's working, and I think, again, you see it in some of the numbers and some of the bigger logos. And all of these deals are competitive. We're going up against the big cloud players as well as legacy incumbents. And we're winning based on a combination of having a feature-complete product and having really strong value. So it's still early, but good progress.

Operator: Okay. Thank you. Our next question comes from the line of Brent Bracelin of Piper Sandler. Your line is now open, Brent.

Brent A. Bracelin
Analyst, Piper Sandler & Co.

Q

Good afternoon. Great to see balancing of profitable growth, positive free cash flow here. Obviously, part of the path to profitable growth has been your own internal look at vendor consolidation. Dennis, for you, as you just think about this vendor consolidation theme, we entered the year with our CO survey saying that there was definitely an appetite for companies to reduce the number of vendors. How is that progressing? We're four months in. Is there a narrative out there that is really resonating with the customers you're talking to at a lower cost, consumer-friendly platform is helping or is that something maybe that could show up in the second half of year? Any color on vendor consolidation and the tailwind of the business?

Dennis M. Woodside
President & Director, Freshworks, Inc.

A

Yeah. Definitely. So we do see in particular in our Freshdesk business, we see consolidation as playing in our favor. So if you look at the – if you look at a typical service operation today, there are multiple different functions that software plays that could be provided by different players in some cases have been in the past. You can buy your bots from one provider, you can buy your second-tier ticketing system from a different one, and you can buy a conversational layer from a whole bunch of smaller players. We've built a best-in-class solution that encompasses all of those things in an integrated way without acquiring any of them. So the code base is clean. The user experience is really slick and we're winning quite a bit of business in rip outs of companies that have chosen a more fragmented approach in the past. So we think consolidation and value is a theme that we're pursuing. It's also much easier for the customer on an ongoing basis to manage us rather than having to manage three or four different solutions, all the integration that goes with that. So that's a winning motion for us and we think that will play out positively.

Brent A. Bracelin
Analyst, Piper Sandler & Co.

Q

So clearly, seeing it in Freshdesk, [ph] have you seen it (00:42:43) across platform consolidation yet at Freshdesk?

Dennis M. Woodside
President & Director, Freshworks, Inc.

A

Yeah. Yes, we're starting to. So if you -- one of the examples was Travel Counsellors today. Travel Counsellors was a or is a Freshdesk customer, they added for sales. And that's more and more common for us where we're seeing customers that have been with us for a couple of years. They've had success with the product and then they're adding a second product, a third product. Again, it's still relatively early for us. Most of our expansion has historically come from seat addition of the same product, but we're leaning more and more into the true cross-sell motion like the Travel Counsellors example.

Operator: Thank you. One moment for our next question which comes from the line of Alex Zukin of Wolfe Research. Your line is now open.

Ethan Locke
Analyst, Wolfe Research LLC

Q

Hey, guys. This is Ethan on for Alex Zukin. Thanks for taking my question. [indiscernible] (00:43:47) customers have started seeing like a continued step down. And I guess it's understandable [indiscernible] (00:43:56) the environment is. But can you just help us think around like how we think that [indiscernible] (00:44:00) and stabilize in 2H? [indiscernible] (00:44:04) linearity, ho we kind of see that in the environment going forward and kind of parse that with your commentary around the [indiscernible] (00:44:11) for NRR. Thank you.

Dennis M. Woodside
President & Director, Freshworks, Inc.

A

Okay. Hey, Ethan. You broke up a little bit, but I think you're asking about the number of customers and then net dollar retention. We are -- we're typically closing about 1,600 to 2,000 customers per quarter. And we came in at 1,500. There's some noise on the SMB on the small side, but the new logos were actually -- I mean, SMB on the small side in terms of churn. But the new logos are actually pretty healthy and the – it's offset from a continued increase in our ARPA. So there's nothing there that we were concerned about really.

In terms of net dollar retention, we came a little bit higher than what we thought and we thought we had a really good quarter of execution there. We're still expanding with customers, but we're continuing to see the pressure on the upsell motion or the expansion motion on agent addition. We're finding other ways to start expanding with our customers. And we had talked about Freshservice for Teams as an example, which is the first real add-on for Freshservice. Now, this is the first quarter is available. But one of the reasons we did better is churn actually came in better in – for the quarter from a dollar perspective, which is a little bit different than what I said from a customer number perspective. We do expect to see a little bit of pressure on churn going forward, but also continue to [ph] express (00:45:31) pressure on the expansion motion. That's why we're talking about a 105% NDR. But we do think it's going to kind of get settled at that as we look at the back half of the year, and obviously, we'll update that as we get more information in the coming quarter.

Operator: Thank you. One moment for our next question, which comes from the line of Brian Peterson of Raymond James. Your line is now open.

Brian Peterson
Analyst, Raymond James & Associates, Inc.

Q

Hey, Tyler. Thanks for taking the question. So I want to follow-up on the last one, just on the NRR. Is there anything that you guys have seen in April that's changed? I appreciate all the perspective that you give. But in terms of that expansion motion, has that changed, I guess, so far in April versus what you saw in March? And is there any element, too, that you guys are just landing bigger or maybe there's kind of less of an initial NRR push and that's a factor as well? Just want to unpack that a bit. Thank you.

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

Yeah. I mean, no real change in April. I mean, we obviously guided today for the quarter. And we've taken everything into account that we know. And so, everything is kind of as expected. And so, there is – there's no real change there in terms of expansion or churn that's different than what we were expecting coming in to the month.

In terms of are we landing more, I would say the sales pattern, we are landing with larger customers, right, and we've been talking about how we've been moving up. And we're not talking about huge companies, right? Dennis just went through the size of companies that we're talking about. But the landing – and if I look at the deals, it doesn't feel like we're having any difference in land in terms of – I think you're alluding to [indiscernible] (00:47:10) or possible like [ph] shelfware (00:47:13) and that people are growing in to what they're buying. And that typically isn't really the sales motion. Most of the customers still kind of buy what they need. It's just that I think that the companies are not hiring as fast as they have been in the past. And then, on the flip side, on the churn side, we have seen down sales, which is included in churn, as companies come up for renewal if they've laid off people. And so, that's just really a macro thing, something we didn't expect kind of coming into last year. And we've been able to adjust the business model accordingly. But I do think that will change. And people – companies will go back to growing and then we will both be able to participate in that.

Operator: Thank you. One moment for our next question. Question comes from the line of Aaron Kimson of JMP Securities. Your line is now open.

Pat Walravens
Analyst, JMP Securities LLC

Q

Oh, great. Thank you. It's actually Pat for Aaron. I was going to ask Dennis the – in terms of the opportunity that you saw here when you took this job. What levers have you pulled so far? I mean, the [ph] 100 farmer (00:48:24) one seems to be one. And what do you still have that you can do in the future?

Dennis M. Woodside
President & Director, Freshworks, Inc.

A

Hey, Pat. Thanks for the question. So, I think we've started – we've really just gotten started on a number of things. I think one of the themes that I've talked about pretty consistently is the opportunity we have to serve true mid-market customers, and that's really still quite untapped. So, Paddy has done an amazing job of laying the groundwork, making sure we've got the right people focused on the right kinds of deals, making sure our field team is winning big deals. And anything that's not over a certain threshold is going to our low cost inbound motion. And that's just – that's still early days. I think some of the hiring that we've done is going to pay off over the course of the year. We brought in a new head of channel. We brought in a new head of strategy and ops who was previously at AWS for eight years. So, those hires are going to start having impact.

I think an area that's really untapped for us is channel, the more I talk to partners and hear what they're hearing in terms of our competitor set and some of the pricing practices that some of our competitors are pulling. They're looking for alternatives in both the CX and IT space and in the Freshsales and Freshmarketer space. I think that's a big lever for us. I think you're going to see, I think, the effect of the changes that Paddy has made in the back half of this year in terms of getting the right kinds of reps, doing the right kinds of things.

And then, we haven't pulled the lever really on true cross-sell, right? We have an expansion motion that's heavily seat addition-driven, but we have the opportunity to do a much better job in selling our IT products into our large installed CX base and vice versa and then bringing in Freshsales and Freshmarketer at the right time.

So all of those things, I think, are still ahead of us. And then, you layer on top of that the – some of the advancements that we're making in AI and the productivity improvements that they will drive for our customers and their agents and managers. All those things are pretty exciting.

Operator: Thank you. One moment for our next question. The question comes from the line of DJ Hynes of Canaccord. Your line is now open.

Luke Hannan
Analyst, Canaccord Genuity Corp.

Q

Hey. This is Luke on for DJ. Thanks for taking the question. So taking a bit of a longer-term view here, but I'm curious if you think we could gradually see a significant structural improvement in net dollar retention over time as you continue to really push up market and push that cross-sell motion, or in your view, is it perhaps a more subtle shift than that?

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

Hey, Luke. So, I think a couple of things will happen on net dollar retention. Coming into last year, we were kind of mid-teens. And a lot of that was – not a lot of it, a big portion of it was driven by that agent addition, which is – has really decreased. At the same time, though, we had brought – when we went public, we are a low-20s churn and we've talked about, hey, we've moved that to kind of high-teens. And we're going to continue to make progress on that. In fact, now, we're kind of like mid to high-teens on churn rate.

So I think over time, we're going to do, I think, three things. One, continue to work on churn and get that to as kind of of – as low as we can. That's kind of a slow moving thing. But as we move to servicing larger companies, as Freshservice continues to grow, be our fastest growing product, which has great churn characteristics. And as we continue to provide value through our products, we expect the churn to come down.

Secondarily, we are working on other ways to grow with our customers outside of agent addition, and Freshservice for Teams is a great example of that, and the cross-sell motion across products, which Dennis just talked about, is another great example of that. That's going to essentially help with expansion outside of that.

And then, third, as we come out of macro, we would expect companies to start hiring again, and then the agent addition will kick back in. If you look at all of that, there's no – we don't think there's any reason we can't get back to that kind of 110% to 115% rate on net dollar retention as those things happen, which, is an extra 10 points of growth for us just from expansion with our own customers. So, we're optimistic about that. We just kind of need to weather this macro storm through the rest of this year.

Operator: Thank you. One moment, please. Our next question comes from the line of Ryan MacWilliams of Barclays. Your line is now open.

Ryan MacWilliams
Analyst, Barclays Capital, Inc.

Q

Thanks. Two questions. Tyler, now that you're non-GAAP profitable and given your net debt position, any change as to how you're thinking about a potential for share repurchases here?

And then, for Dennis, you may have alluded to this in your prepared remarks, but some of your competitors have raised prices in recent quarters. I know Freshworks offers a cost effective sale for its customers, but do you have any new thoughts on potentially raising prices across different products, tiers or geography? Thanks, guys.

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

Okay. I'll take the first piece first, Ryan. So, we're about a year and a half into being public. Here, we kind of said it's kind of three-step process: get to sustainable free cash flow positive first; then get to sustainable non-GAAP operating profit; and then, third, GAAP operating profit. I think we've done the first. The second, we're just in the first step of doing. And then, once we're really confident there, then we would look at our cash. Obviously, we're very healthy and we still have $1.1 billion in the bank and we have no debt and we're going to start producing cash. We are using that cash right now, parts – part of it to do net settles of RSUs. We used well over $100 million last year to do that. I think we used about $17 million last quarter. And that is kind of a form of buyback, if you look at it that way, because those shares will never hit the market. And then the broader point of what we do with our cash of it is not used for operations. That's clearly a board discussion that we would have with them at some point in time.

Dennis M. Woodside
President & Director, Freshworks, Inc.

A

Yeah. On pricing, I think we do have leverage. We've – we took prices up for ITSM in January for new customers and renewals by about 4%, and we didn't really see much in the way of pushback. Our – first of all, the price umbrella between us and either like a BMC product or ServiceNow is quite big. And secondly, the – our customers are getting a lot of value out of the solution. So, there potentially is more there.

The other area that we're looking at is at renewal, we – when we're coming up to renewal historically, we've had a number of customers that are on fairly discounted deals. We're revisiting those discounts as part of the renewal discussion and we're able to effectively erase price at renewal as well. So, I think there are more and more levers. We are getting more sophisticated about how we're thinking about pricing, and that's another area that I'm certainly digging into.

Operator: Thank you. One moment. Our next question comes from the line of Nick Altmann of Scotiabank. Your line is now open.

Nick Altmann
Analyst, Scotiabank

Q

Awesome. Thanks, guys. You guys, over the past several quarters, have talked about how ITSM Freshservice has been a strong area and an area that you guys are leaning into. When you look at sort of the bookings this quarter, can you just maybe talk about the bookings strength between Freshservice, Freshdesk, Freshsales, et cetera?

And then, just as a follow-up, do you think ITSM is maybe holding up a bit stronger, budgets are a little bit more inflated there and it's a bit more upmarket, or do you think it's sort of a front office versus middle office versus back office dynamic and maybe buying propensity is a little bit better in ITSM versus other areas? Any commentary around those aspects would be very helpful. Thanks.

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

Hey, Nick, this is Tyler. So in terms of the bookings by product, we haven't really broken that out. And we do plan on our Investor Day to get more kind of product ARR information. But what we have said is that ITSM has been the fastest growers, the biggest contributor to ARR growth, and that continued in Q1. The product is doing great. And we also called out that is actually a really good kind of new business quarter there.

Now, you asked, is there – hey, is there more budget? I think it is interesting that I don't necessarily think that ITSM has more budget. In fact, on the smaller companies, what we would see is that those customers would wait in times like this and they kind of stay with just e-mail and whatnot for their ITSM. And so, I think that's a future opportunity for us as companies get a little bit more budget that they would look to us to buy. I actually look at it more as this – the opportunity in the market of our product and the value that that product can provide, and then also be a great value for, say, existing ServiceNow customers who are tired of that product, that we can provide an incredible alternative. And that's what we've been leaning into and that we're going to continue to do that, and also specifically with the legacy vendors there. And so, it is a great space and we're going to continue to grow – capture as much as possible.

Dennis M. Woodside
President & Director, Freshworks, Inc.
A

Yeah, Nick, one other thing I – this is Dennis – I call out is the investment that we've made over the last several years in the product and the IT product, in particular, is absolutely critical in winning deals. So, think about ITOM capability that we didn't have a year ago or an ESM solution that works for teams outside of IT that we didn't have a year ago. These are really important developments for us that allow us to address a broader range of customers, and that's showing up in the numbers.

Operator: Thank you. Our next question comes from the line of Brett Knoblauch from Cantor Fitzgerald. Your line is now open, Brett.

Brett Knoblauch
Analyst, Cantor Fitzgerald & Co.
Q

Hi, guys. Congrats on the quarter and thanks for taking my question. You talked about being more involved in more deal opportunities. I guess is this a trend that you have seen accelerate given [indiscernible] (00:59:09) budgetary pressures you're seeing with some larger enterprises?

Dennis M. Woodside
President & Director, Freshworks, Inc.
A

Hey, Brett, it's Dennis. So yes, we are – one of the things we look at is how many swings of the bat do we get per quarter. And once again, Q1 was greater than Q4, and Q4 end of year, historically a pretty good time of year to get that kind of volume. So, we're in the mix more. We're in larger situations. So we're swinging at fatter pitches, so to speak. So, the deals that we are getting involved in on average are bigger than they have been in the past. And I think that's back to the product innovation both for CX and for IT. That goes to all the investments that we've made in conversational and automation on the CX side and in ITOM and ESM and other features on the ITSM site.

So, it's a really important metric for us. It demonstrates that the network that we're building in terms of referrals and customers that are happy and talking to other customers. All that stuff comes together in looking at how much are we participating in new opportunities, of course, how many of those are we winning. So, we think it's an important trend. And I do think in talking to customers, they are looking for value, and in many cases, they're not satisfied with whatever solution they have, whether that's an old on-prem solution or a newer cloud solution.

Brett Knoblauch
Analyst, Cantor Fitzgerald & Co.
Q

Perfect. Thanks, guys. I appreciate it.

Operator: Okay. Thank you. At this time, I'd like to turn the call back to the company for closing remarks.

Joon Huh

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

Great. Hey, thanks for everybody joining us. We look forward to meeting with you and speaking with you throughout the quarter, and we'll catch up with you next quarter. Thank you.

Operator: Thank you all for your participation in today's conference. This does conclude the program and you may now disconnect.