

12-Sep-2023

Freshworks, Inc. (FRSH)

Piper Sandler Growth Frontiers Conference - Fireside chat

CORPORATE PARTICIPANTS

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

OTHER PARTICIPANTS

Brent A. Bracelin
Analyst, Piper Sandler & Co.

MANAGEMENT DISCUSSION SECTION

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

Good morning.

Brent A. Bracelin
Analyst, Piper Sandler & Co.

Good morning. Can you hear me? Okay, we'll try this again. My name is Brent Bracelin. I'm the co-head of tech here at Piper Sandler. Thank you all for joining us in Nashville.

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

We're now awake, yes.

Brent A. Bracelin
Analyst, Piper Sandler & Co.

It's a wake up call. Really pleased here to have Freshworks. We're going to kick off the fireside discussion today after the State of AI presentation and discussion. Very insightful this morning, but pleased to have Tyler, CFO of Freshworks. Tyler, welcome to Nashville.

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

Brent, thanks for having me.

QUESTION AND ANSWER SECTION

Brent A. Bracelin

Analyst, Piper Sandler & Co.

Q

Absolutely. So, you just came off your first, I think, Analyst Day since the IPO a couple of years ago.

Tyler Renwick Sloat

Chief Financial Officer, Freshworks, Inc.

A

Yeah.

Brent A. Bracelin

Analyst, Piper Sandler & Co.

Q

Maybe we'll start with the highlights. What were some of the key messages and disclosures that you provided investors last week?

Tyler Renwick Sloat

Chief Financial Officer, Freshworks, Inc.

A

Sure. Yeah, we did our first Analyst Day last week in San Francisco, almost at the two-year anniversary of our IPO, which I think is next week. One of the things – we knew there have been strong appetite to kind of get a little bit more insight into the product level data on ARR and whatnot. And so, we did disclose that. We bought back up – as a reminder, we're about 13-year-old software company, really playing in three massive TAMs.

Our biggest product, which we said, is about \$300 million is Freshdesk. It's our customer service product that was really playing from the SMB all the way up to kind of the low enterprise, doing on a global basis, across kind of three go-to-market motions, which is true for all of our products. An inbound SMB motion, which is a high-velocity motion, where a potential customer will land on the website, they'll start trial a process and convert. We have a field motion which we've kind of built out over the last couple of years, but it's really still – I'd say we're still tweaking it as we learn, and that motion is there because we've earned a right to go engage with larger customers, which was another theme of our Investor Day, kind of disclosing some of the data around our larger customers and the customers paying us greater than \$100,000 is what we put out there. And then, we have a partner motion.

So, Freshdesk, our customer service product, about \$300 million. Freshservice is our fastest-growing product is playing in the ITSM space. It's about \$260 million in ARR, growing very fast and just positioned really, really well. And then, we have a sales and marketing product that we disclosed the numbers, still new for us. It's still small. We're very excited about it. We're working on it. And that one is what we believe can be our next \$100 million product in the coming years.

Brent A. Bracelin

Analyst, Piper Sandler & Co.

Q

If I look at the software industry as a whole, we've kind of been in this deceleration mode. We look at the cloud tracker, hundreds of software publicly-traded companies. Growth rates across the industry have kind of basically been cut in half in the last two years, but we're starting to see some stabilization. But one of your products has just been a growth engine that's Freshservice, right? You kind of gave some specific ARR numbers there last week, \$260 million ARR business, growing 40% year-over-year. How has that business done so well? It seems to

have bucked some of the slowdowns and moderating growth trends we've seen across the broader software market. What's happening there? What's driving that?

Tyler Renwick Sloat

Chief Financial Officer, Freshworks, Inc.

A

Sure. The genesis of Freshservice was we actually saw much of our Freshdesk customers using it for internal use. And we said, okay, that's great, but that's actually not what you need in your purpose-built solution. And so, we've built it ground-up. And G, our Founder, he had already built ITSM solutions in the past, built it ground-up to serve customers' needs for internal use. And it starts with IT and IT ticketing, and we've recently announced Freshservice for Teams, which is actually for other functions within organization.

If you look at – by building it ground-up, purpose-built and really SaaS-first and just focused on modern technologies, which is also injecting AI and everything else into our Freshservice is really competitively positioned very, very well in a market that's dominated at the top end by ServiceNow, and then as a whole bunch of legacy players on the side, which is still a ton of on prem, and then you've got kind of Atlassian with their JSM product, and manage engine kind of at the bottom.

And so, we're regarded as kind of a number one SaaS alternative under ServiceNow in that space. And we've just been innovating really, really quickly. So, two – right when we went public, we actually talked about it kind of as a second product. We didn't have – we didn't say a ton about it, because reality at that time, the product wasn't quite there yet, and just the pace of innovation we've been able to do has really earned us the right to go engage with a lot of larger companies. And so, that is truly playing in kind of that low end of enterprise, so we call it kind of the 5,000 to 10,000 employee businesses, and squarely in mid-market as well, which is up to 5,000 for us, and doing incredibly well.

Brent A. Bracelin

Analyst, Piper Sandler & Co.

Q

So, if you think about that Freshservice opportunity really capitalizing on that number one alternative ServiceNow, what about the core? The core has slowed, the core customer service product has slowed. You got the macro headwinds a little lower and customer base a little more churn in that market. What are the levers that could maybe reaccelerate growth in the core?

Tyler Renwick Sloat

Chief Financial Officer, Freshworks, Inc.

A

Yeah. So, we highlighted a bunch of levers that we're focused on for growth kind of going forward, but if I describe what's going on with our Freshservice product, it's really two things. First, at the end of our 2022 Q1 call, we talked about starting to see something happening in kind of the market, and it was kind of the theme all last year, which was really that companies just weren't growing, right? And they weren't hiring. In some cases, they were downsizing. This actually impacted our Freshservice product the most. If you think about that, it's servicing companies who have large – potentially large support groups and could rapidly grow as those companies did well.

As such, what would happen in Freshservice – I mean in Freshdesk, we typically land smaller and grow with our customer base. We actually highlighted this in last week's Investor Day, where we talked about customers greater than \$5,000 were landing there consistently, but our customers greater than \$50,000 and \$100,000, we're really growing into that more than we are landing, and it's – a lot of that's driven by our customer service product.

What happened over the last 18 months is that the impact to our upsell motion was really impacted by companies not growing. And so, that is actually what's also driven our net dollar retention down. And so, okay, we're going to have to figure out a way to grow with our customer base outside of agent addition. And so, there's a couple of things we're doing. First of all, really making sure we stay in line with what the market wants. And the first thing is that everything's moving to more conversational messaging as opposed to traditional ticketing. And so, we released our customer service suite recently, which is really bringing a ton of the traditional desk functionality, and really anchoring it around chat. And that the Freshchat product is now really built for WhatsApp, Apple Business Chat, everything else to bring kind of this common view and template to our customers, and so that's the core of it.

Outside of that is really thinking about, okay, how do we inject growth across not just our Fresh – our customer service product, but our sales and marketing product? So, we talked about our PLG 2.0. And so, PLG is a product-like growth motion, really – I talked about the first thing is high-velocity inbound, something we really haven't kind of touched much in the last, let's call it, seven years. So, really revamping the entire trial process and how customers land specifically because you have to have a customer to be very sophisticated who lands, who really understands versus the very small SMB. And they actually have to have different journeys and so we're working on that. Working on cross-sell of our products. Only 25% of our customers use more than one of our products and that is actually mainly driven by add-ons as opposed to our core products, and so having prescriptive motions to increase the cross-sell amount.

Looking at our new AI products that we have out there and really ensuring that, number one, we do it right first, but then actually how do we increase probably starting with bot usage, which will lead to monetization as well as the copilot product we have and really focused on making sure that we're – that's getting traction. New products as well, and continue to introduce new products and we're continually innovating as fast as we can to think about that. Freshservice for Business Teams is a great example.

And then, lastly would just be broader economic stabilization, which we're not really counting on, to be honest and that one is kind of the last on the list of what would have impact.

Brent A. Bracelin

Analyst, Piper Sandler & Co.

Q

The disclosure on the top 20, I think the top 25, I think there was 10 customers that had desk and service. And then, I think 2 of the 20 that had all four products, service, desk, and sales and marketer. As you think about that multi-cloud opportunity, we hear a lot about vendor consolidation. We have a very compelling ease-of-use story and a compelling cost story as well as I think about the value of Freshworks. When do you see or are there catalysts that could accelerate multi-cloud adoption? Are there certain things that you think you can control to drive broader adoption?

Tyler Renwick Sloat

Chief Financial Officer, Freshworks, Inc.

A

Yeah. So, Brent was talking about, we did have a slide up there, highlighted our top 20 largest customers and then what products they use. And every single one of them actually was a customer service product owner, and then a lot had also Freshservice. One of the catalysts that we see is that, okay, Freshservice has increased so much that – and it's incredibly well-received that selling to the Head of IT, often a CIO or a VP of IT. Now that we have that mindshare, we need to leverage it more, which I can't say we've done an incredible job on. And the reason we need to leverage that is that individual often has a lot of decision power on other software things, purchases being made. And so, I think that's going to be one thing that we're going to be focused on specifically in our field motion.

But the other area is really with our customer service suite, adjacent to our Fresh sales and marketing product. And that is just a natural add-on thinking about from the lead all the way through to support being able to provide our customers this seamless journey for their customers and that's something we're very focused on as well.

Brent A. Bracelin

Analyst, Piper Sandler & Co.

Q

The Freshservice CIO seems like it's a more important buying center, as that becomes more important part of the business, growing 40%, is that really the insertion point that you're going to sort of tactically focus on to cross-sell? Is it easier to cross-sell land with Freshservice or is it easier to land and expand with Freshdesk?

Tyler Renwick Sloat

Chief Financial Officer, Freshworks, Inc.

A

I don't know if one is easier than the other. I think what I think we're doing – and I said we're just continually tweaking the field motion is that we're realizing it's probably unrealistic to think that our reps can be experts on both, that they could have deep knowledge on, say, support, but also deep knowledge on IT, because IT is now broad in not just to ticketing, which is kind of ITSM, but it's ITIL, it's ITOM, it's ITAM, and now other functions, and you have to have an understanding of that.

So, you'll see us creating probably experts, right, and we've done a little bit of that this year, it's kind of new on overlays, but I think that'll continue to evolve. And to be honest, we're agnostic as to where we land, right? The question is, once we land, can we be super successful with our customers and make sure they understand that we do have these other product offerings? And that's, I think, the area that we haven't been great at. If we go query our customers, oftentimes they don't even know that we might have some of the other products out there.

Brent A. Bracelin

Analyst, Piper Sandler & Co.

Q

Let's spend some time talking about the demand environment. I would love to compare, contrast the demand visibility you're seeing today versus a year ago. I think a year ago, you started to see cracks, right? You start to see churn pick up a little bit, you start to see net retention rates slow down. The expansion, specifically we're challenging maybe compare the environment one year ago versus the demand environment you're seeing right now.

Tyler Renwick Sloat

Chief Financial Officer, Freshworks, Inc.

A

Yeah. Yeah. So, our net dollar retention, when we went public, were in the mid-teens. And at the beginning of last year, we were kind of, let's call it, 110-ish low teens, and we said, hey, we're going to go down a 105% or 106% this next quarter. And then, we think it's going to stabilize. To be clear, our churn actually, we've done better at. And so, we've actually reduced the churn kind of every single quarter or it's remained stable.

And so, when you think about that, if you have a tailwind on the churn side for net dollar retention, really the downside is really coming from expansion. And that expansion was already – that's almost all of it is really being driven by the lack of agent additions, a lot of it on the customer service side. We're not seeing that come back right now. It's not like, okay, this was a temporary thing, and it's coming right back. And I said and the levers for growth, broader economic stability, I think, is that last thing that we're saying we can't count on.

And if companies go back to hiring, that's fantastic. But I don't see it happening right away. I do think we're in the new normal is just the way we also run our business, which is all my CFO peers are doing the same thing, right? We're being very prudent about hiring and making sure that we're hiring the right people in the right places. We're still hiring a ton of people, we are, at Freshworks, but it's not at the pace that we were previously. And so in general, I think we are kind of living in a new world, so to speak, and that companies need to adjust. And if they were reliant on a ton of their customers just rapidly expanding, they need to figure out how to grow outside of that.

Brent A. Bracelin*Analyst, Piper Sandler & Co.*

Q

So, near-term demand environment kind of feels like we're in this new normal. No real change on the expansion opportunity – agent expansion opportunity that's been challenged for a while, continues to be a challenge. As you think about just the business model, though, you are seeing a mix shift to this Freshservice ITSM opportunity that seems like you have a lot of momentum. Will that change your NRR? Have any impact three years from now just as you think about mix shift? And if not, what does change the model with that mix shift, especially?

Tyler Renwick Sloat*Chief Financial Officer, Freshworks, Inc.*

A

Yeah, I'm not sure it'll change. We do think we should be a 110% kind of net dollar retention business, and so the focus is how do we get back there and that's kind of what we talked about when we went public, think about us as kind of this 110% net dollar retention.

Freshservice has actually great like churn characteristics. It's got what I would consider enterprise-grade kind of retention, but we also tend to land larger there and not expand as much. So, there's six in one, half-dozen in the other, from that impact. We are focused on the new products within Freshservice, but mainly Freshservice for Business Teams. That is really the first new add-on product we have there, and that is kind of six months old, if I describe it. And so the expectation is that will get traction, and we would be able to upsell our customer base off of that. And so, I'm not sure how it'll change our net dollar retention going forward, but I think we do look at that across the entire spectrum of the customer base. I think the real change there is, if you have a very happy customer and it's a pretty sticky product, can we get more engagement on the other products with those customers.

Brent A. Bracelin*Analyst, Piper Sandler & Co.*

Q

So, obviously, it's been a challenging couple of years for all of the software companies from a valuation perspective. Feels like we're kind of bottoming as I think about your business model, billion dollars in net cash, you talked about a new CS suite, potential lever. You talked about PLG 2.0, potential lever for next year. You talked about these new AI products. You have obviously some changes to the sales team that you've made there with some new leadership. Sounds pretty good in my view, outside looking in, but what keeps you up at night, as you think about kind of going into next year? What are the things you're worried about?

Tyler Renwick Sloat*Chief Financial Officer, Freshworks, Inc.*

A

Yeah, I don't know if it's what I'm worried about. I mean we have to go execute, right? That's just – we laid out a kind of a plan, and with advantage of different growth levers. What we did say last week is, first of all, we're going through this three-step process on what I would consider the whole business model. First step was to get to sustainable free cash flow positive. The second was to get to non-GAAP operating margins and the third is the GAAP, to get to GAAP. I think we've knocked off the first two this year. And we kind of levered some efficiency

muscle coming into this year, and it wasn't – we didn't have to do anything dramatic. It really was as a result of the fact that we were hiring so fast in the last couple of years, that we slowed that down and really focused on efficiencies. So, we have flipped to producing cash, which is great.

Second thing we said, okay, we're very focused on Rule of 40 and we're going to get ourselves there and we said we'll be Rule of 40 by 2025. Right now, we're essentially Rule of 30 with 19% growth for this year on the top side, and 10% free cash flow margin. By 2025, we expect to be half-half. And then, we also said we'll be \$1 billion in revenue by 2026. And when we laid out, what we'll look at – what we'll look like in 2026, a lot of the growth is going to be on the back of Freshservice. It's going to be continued increase in ARPA across our customer base and larger deals, which is the trend that we've seen. We built that entire model based on what we see today, and then those growth levers that we laid out would be on top of that.

The thing that keeps me up is the execution against those growth levers and making sure we're on track to go do those things, which – it's a good spot to be in. I think we are in control of our own destiny. We just need to go execute.

Brent A. Bracelin

Analyst, Piper Sandler & Co.



Before we dive into kind of an AI-specific discussion, we've gone 20 minutes without AI, so that's probably a good...

Tyler Renwick Sloat

Chief Financial Officer, Freshworks, Inc.



That's good, yeah.

Brent A. Bracelin

Analyst, Piper Sandler & Co.



...a good approach.

Tyler Renwick Sloat

Chief Financial Officer, Freshworks, Inc.



I have been through it out once for you and you didn't pick it right there.

Brent A. Bracelin

Analyst, Piper Sandler & Co.



No, no, not going there, [indiscernible] (00:19:59). Any questions from the audience here before I go into my last two questions on AI? Okay. Let's spend some time talking about AI [indiscernible] (00:20:11) AI products you have, but how you're thinking about using AI internally the lower cost?

Tyler Renwick Sloat

Chief Financial Officer, Freshworks, Inc.



Well, we use our own products, so that would be the first thing that we do, right, by using our own product.

Brent A. Bracelin

Analyst, Piper Sandler & Co.



What's the biggest area internally that using your own products has helped you save money? Is it in support? Is it in engineering?

Tyler Renwick Sloat*Chief Financial Officer, Freshworks, Inc.*

A

I don't think it's in engineering. Yeah, I don't think that stuff has been rolled out as much. It has to be in support, would be my guess. I don't actually have a clean answer to that in terms of the quantification of it all, but I'm assuming it's in support. Even if I look at our margin structure, I think we're really pretty healthy on margins with support flows through and so that's got to be the area.

I think as a CFO, we're all looking at how do we build whether it's AI or just automation into as much stuff as possible. And that's just going to be a continued theme through kind of you think about all your operational tracks, how you kind of drive those tracks to be as efficient as possible, while also reducing kind of human intervention where possible, which reduces errors and increases your capability to do things faster, more accurately. And so, we're looking it across the whole business.

Brent A. Bracelin*Analyst, Piper Sandler & Co.*

Q

Internal use cases sounds like it's still TBD, but like I definitely feel like part of the automation strategy externally as you think about growing revenue, what's the – led the feedback on the AI feature that seems to be [indiscernible] (00:21:45) the most?

Tyler Renwick Sloat*Chief Financial Officer, Freshworks, Inc.*

A

I think we've highlighted two things. What we did on the Investor Day last week is, we actually did demos of the products, but the demos were live, and so they're actually all stuff that is live either in GA or beta right now, and we have thousands of customers beta-ing our products. Specifically, we've announced kind of self-service and copilot. And we call it Freddy, it's our internal moniker for our AI products.

The thing is, we've always had Freddy. And we've talked about Freddy when we went public, and so now we're kind of like Freddy+, which is really kind of supercharged with large language model, built to be able to take care of all those capabilities. The one thing we came out already and we changed our bot pricing. And so, it's not – it's tangential to AI, but the AI is now built into a lot of that capability. And previously, we had entitled customers who bought Freshchat with a bunch of included number of bot sessions, and then the packs – the charge for packs was lower. And so, we increased the additional packs and we actually reduced the entitlements.

The exciting thing there is not just about the capabilities within the bots that is really AI-driven, but also the bot builder that we've come out with, which one of the biggest hurdles was that a company we had the bot capability, but they had to build the bots, and not every company could go do that or had the expertise to go do that. Now, you don't really need technical expertise internally to be able to do that, because there is a bot builder that Freddy helps you build the bots you need to build, which we're pretty excited about.

Brent A. Bracelin*Analyst, Piper Sandler & Co.*

Q

The expose data to the bot, the bot builds the bot for you.

A

Tyler Renwick Sloat*Chief Financial Officer, Freshworks, Inc.*

Yeah. Yeah. One of the quotes from last week is bots building bots, which is pretty neat. The other is Freddy Self Service, which is really focused on so – or Freddy Copilot. So, Self Service is really bots, which is really how do we actually create the capability for our customers to engage with their customers and solve problems without human intervention. Freddy Copilot is how do we help the agents actually do their jobs better. And we announced a bunch of products there. They're all out right now. They're all in beta and it's pretty exciting they're using that. We've got some incredible feedback from customers. We're going to make sure that it's tested a ton and then we roll it out and actually start charging for it, because it has to be accurate. You have to prove value, if you want to charge. And the more it gets used, it's smarter it gets, so that's what we're doing right now.

Brent A. Bracelin*Analyst, Piper Sandler & Co.*

We're out of time here, but thank you so much, Tyler, for sharing your thoughts here this morning, and hopefully have some [indiscernible] (00:24:35).

Tyler Renwick Sloat*Chief Financial Officer, Freshworks, Inc.*

Thanks for having me. It's great.

Brent A. Bracelin*Analyst, Piper Sandler & Co.*

Absolutely.

Tyler Renwick Sloat*Chief Financial Officer, Freshworks, Inc.*

Thanks, Brent.

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